UNITED STATES POSTAL SERVICE

Annual Report 2001

For more than 200 years, the United States Postal Service has kept the American people connected by mail, delivering to more than 137 million households across our great nation six days a week.

Our work is a proud, time-honored tradition. And, though we find ourselves facing a trying time in our nation's history, our resolve is unwavering. We will continue to deliver America's mail.

Through adversity in the form of unprecedented acts of terrorism, the 800,000 men and women of the United States Postal Service remain committed to keeping our nation's fundamental communications network delivering.

We, the United States Postal Service, stand united with our employees, with customers, with legislators, with the mailing industry and with American businesses.

We stand united with America in the cause to hold our great nation, and our way of life, together.

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how to read our **ANNUAL REPORT**

WELCOME TO OUR WORLD

Inside the pages of this United States Postal Service 2001 Annual Report, we will tell you a story of unity. We'll explain how we at the Postal Service — all 800,000 of us — are focused on developing people, improving service, managing costs, growing revenue and pursuing reform. And we will show you how that focus is helping to ensure a more efficient and highly responsive Postal Service — one positioned to continue fulfilling our mandate of universal service to the people of America.

We've worked to make sure this report contains the facts that you need to know about your Postal Service.

You'll find our financial highlights below. Page 3 contains a summary of the year's business and operational highlights. Postmaster General and Chief Executive Officer John E. Potter, and Robert F. Rider, Board of Governors Chairman, have written a letter to America on page 4. In it, they talk about our efforts to continue our long tradition of trust, innovation and service. They address our accomplishments and challenges and outline our plans for the future. The pages that follow contain a thorough review of our performance through a very challenging period. Then page 15 begins an in-depth discussion of our finances.

Throughout 2001, the Postal Service has continued to build on a solid record of accomplishment. We kept service at record heights, achieved greater levels of efficiency and kept pace with the needs of a growing nation. Despite the limitations of a legislative charter more than three decades old, the Postal Service carries almost half of the world's mail — and does this huge job in a business-like manner — without operational subsidies.

This is the story of your Postal Service in 2001.

FINANCIAL HIGHLIGHTS

	YEARS ENDED SEPTEMBER 30			PERCENTAGE CHANGE FROM PRECEDING YEAR		
(dollars in millions)	2001	2000	1999	2001	2000	1999
Operating revenue	$65,834	$64,540	$62,726	2.0%	2.9%	4.4%
Operating expenses	65,640	62,992	60,642	4.2%	3.9%	4.9%
Operating income	194	1,548	2,084			
Operating margin	0.3%	2.4%	3.3%			
Net (loss) income	$(1,680)	$(199)	$363			
Capital cash outlays	$2,961	$3,337	$3,917	-11.3%	-14.8%	28.2%
Total debt	11,315	9,316	6,917	21.5%	34.7%	7.7%
Interest expense on borrowings	306	220	158	39.1%	39.2%	-5.4%
Capital contributions of U.S. government	$3,034	$3,034	$3,034			
Accumulated losses at end of year*	(5,360)	(3,680)	(3,481)			
Total net capital deficiency	$(2,326)	$(646)	$(447)			
Number of career employees	775,903	787,538	797,795	-1.5%	-1.3%	0.7%
Mail volume (millions of pieces)	207,463	207,882	201,644	-0.2%	3.1%	2.4%
New addresses served	1,736,256	1,893,377	1,459,261			

* Losses accumulated since the Postal Service was created in 1971 with mandate to set rates such that revenue covers costs.

2001 **HIGHLIGHTS**

MAKING THE GRADE. We scored high marks on *Government Executive Magazine's* Federal Performance Report, earning A's in managing for results, financial management and physical assets management.

GIVING CONSUMERS GREATER CHOICE. Our groundbreaking business alliance with FedEx provided the air transportation network we needed to meet customer requirements for more reliable service and reduced costs. The agreement has doubled the market reach of Express Mail Next Day®, and Priority Mail Two Day™ services.

PRIORITIZING COMMITMENTS. We restructured our organization to bring more focus to priorities and the core business. Changes in our headquarters and field organization are enabling us to better serve the American people by establishing a leaner management structure.

IMPROVING OPERATIONS. Technology upgrades that track mail and enhance accounting and timekeeping systems enabled us to provide near real-time mail flow information to large mailers and postal operations. Mailers can track their mail as it flows through our automated mailstream. The Postal Service can better match equipment and staffing to workload, improving productivity and reducing operating costs.

CHAMPIONING SMALL AND LARGE BUSINESSES. We're making Priority Mail® more affordable and offering mailers more options and greater value. Experimental Priority Mail Presort discounts are measuring the costs of mailer presortation to determine if incentives would be attractive and beneficial to mailers.

TAKING PRIDE IN OUR PERFORMANCE. External First-Class Mail® delivery scores, as recorded by PricewaterhouseCoopers, showed that 94% of First-Class Mail destined for next-day delivery received overnight service.

DOING OUR PART. We received seven White House "Closing the Circle" awards for environmental achievement, bringing our total to 37 awards since the recognition began in 1995.

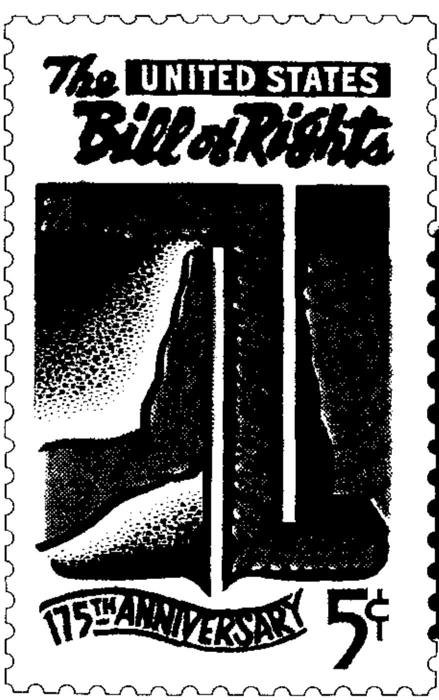
OPENING EYES. As part of our mission to bind the nation together, we partnered with the Dave Thomas Foundation to focus national attention on adoption. The Adoption stamp provided a vehicle for highlighting this important cause.

TURNING HEADS. For the second year in a row, *Fortune Magazine* ranked the Postal Service among the nation's top 20 employers for minorities.

BUILDING OUR BRAND. Our Pro Cycling Team, led by Lance Armstrong, delivered its third consecutive win at the world's foremost cycling event, the Tour de France.

DELIVERING FOR OUR NATION. In the wake of the September 11th tragedies, we maintained normal collection, processing and delivery of mail to the people and businesses of America.

SHAPING OUR FUTURE. At the request of Congress and the Comptroller General of the United States, we are developing a comprehensive Transformation Plan to position the Postal Service for long-term success in an increasingly dynamic market. The plan explores changes possible within our existing legislative framework, moderate legislative change to increase flexibility in key areas, and options for long-term, comprehensive changes to shape and support the Postal Service of the future.

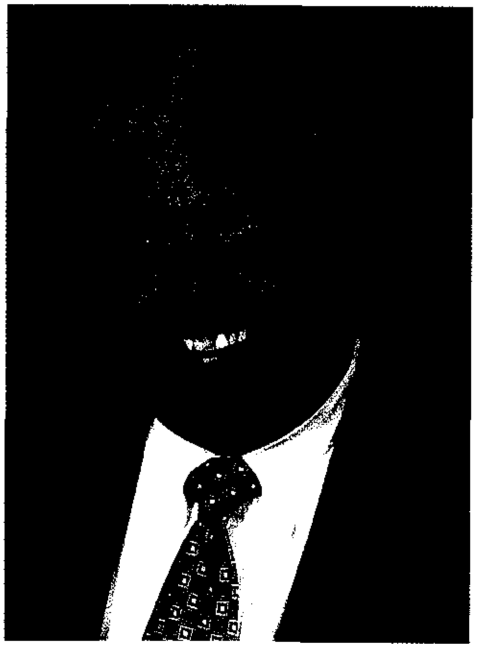


...OF THE UNITED STATES OF AMERICA...

a letter from the **POSTMASTER GENERAL/CEO** and

To the President, members of Congress, postal employees and the American people.

This is a time unlike any other – both for the Postal Service and for America. It is a time that calls for strength, courage and the determination to move ahead. Above all, it calls for unity.



Each of us in the Postal Service is working to deliver secure, affordable and universal mail service to the people of America. That is our job and we will continue to do it.

Yes, we face some challenges. A changing economy and rising labor costs have driven up our costs while they have reduced our revenue.

...AND TO THE REPUBLIC...

the CHAIRMAN, BOARD OF GOVERNORS

At the same time, our fixed costs have risen as we expanded to serve more than 1.7 million new addresses last year. A strong and focused response has helped us to reduce expenses, while maintaining consistently high service performance.

The Postal Service has been a reliable, trusted provider of communications for more than two centuries. It is a basic and fundamental service provided to the people of America by their government. It helps keep Americans in touch, and it is the hub of a $900 billion mailing industry. We are working to keep this critical national asset strong and vibrant, today and far into the future.

From a business perspective, we are pursuing joint strategies of increasing revenue and managing costs. To help us accomplish these goals, we are completing an organizational restructuring that better aligns our operations, marketing and sales activities. These changes are also bringing greater efficiency to our administrative and support functions.

Our combined efforts have resulted in the removal of more than $900 million in costs from our system. We consider that quite an accomplishment.

Looking to the future, we are completing a comprehensive transformation plan that will help to position the Postal Service for continued success in an increasingly dynamic market. We are taking a three-step approach to this effort.

The first is the implementation of significant and positive actions to drive efficiency and performance within our existing legislative framework. The second is seeking modest legislative change that would bring modern management tools to postal operations. The third is identifying options for long-term comprehensive changes what will define and support the role of the Postal Service well into the 21st century. Development of this plan has been among our highest priorities.

We cannot say often enough how proud we are of the 800,000 men and women of the United States Postal Service. Through unprecedented adversity, including acts of terrorism that resulted in the loss of two dedicated employees, they have continued to do their jobs and proudly upheld the principles of universal delivery service.

We are grateful to every postal employee, in every city, and in every town, for understanding the importance of our work in service to the American people. On behalf of the United States Postal Service, we thank them for helping us to stand united with the nation we serve.

Sincerely,

John E. Potter

John E. Potter
Postmaster General and CEO

Robert F. Rider

Robert F. Rider
Chairman, Board of Governors

2001: UNITED WE STAND

It was the regular, monthly meeting of the Board of Governors at the Postal Service's Washington, D.C. headquarters. Through the windows, some who were attending the meeting saw a brilliant orange flash and dark smoke across the Potomac River. It was September 11. A jetliner hijacked by terrorists had just struck the Pentagon, following similar attacks on New York's World Trade Center. Our nation was at war.

Through the anxious days that followed, the Postal Service continued to do what it does best — deliver the mail. The appearance of letter carriers making their rounds in virtually every community, both on the day of the attacks and over the next week, helped to reassure the nation that the fabric of everyday life, although damaged, was intact. That damage included our Church Street Station, located in the shadow of New York's Twin Towers. Our employees got out safely, and the Postal Inspection Service secured the mail until delivery arrangements could be made for customers in restricted areas of New York.

The temporary suspension of commercial airline traffic and new security restrictions imposed by the Federal Aviation Administration resulted in significant shifts of mail from air to surface transportation. Our new alliance with FedEx was invaluable in keeping as much mail as possible in the air. Despite the changes imposed on our operations, we continued to serve the American people with high levels of performance.

Subsequent to the fiscal year, terrorists used the mail to attack representatives of our government and the media. Tragically, two Postal Service employees, Joseph Curseen Jr. and Thomas Morris Jr., were among five Americans who died as a result of this assault on our freedom. The men and women of the Postal Service found themselves on the front lines of a new kind of war. They became quiet heroes simply by doing their jobs and keeping the mail moving.

Meanwhile, we worked to keep the mail safe, through a nationwide campaign of education, investigation, prevention and intervention. Every address in America received a postcard with information about how to identify — and what to do with — suspicious mail. The Postal Inspection Service, working with the FBI and other law enforcement agencies, continued investigating all leads. The Postal Service and the FBI offered a reward of $1 million — augmented by an additional $250,000 from direct mailer ADVO — for information leading to the arrest and conviction of those responsible. Personal protective equipment and new operational procedures brought added levels of protection to our employees. Finally, we purchased sanitization equipment and services to eliminate biological hazards from some mail before it enters our processing system. We are also exploring detection technologies.

For over 200 years, the mail has been a welcome and trusted daily presence in every home and business in America. We are doing everything possible to keep it that way.

...FOR WHICH IT STANDS...

"It is fitting that the U.S. Postal Service — which has served the people of this nation since the dawn of our Republic — will issue the United We Stand postage stamp. For our primary mission has always been to bind the nation together."

Robert Rider, Chairman, United States Postal Service Board of Governors.

united we stand with EMPLOYEES

The Postal Service's greatest strength is the dedication of the men and women who move America's mail. Our commitment to them is second to none. From safety to the workplace environment, from skill-building to leadership development, we're united with our employees to help serve you better.

And they agree. Every year, we ask each career employee how we're doing and how we can do better. This year, we experienced one of the highest response rates ever. And employees are telling us that we're doing a good job in creating a workplace environment that values inclusion and delivers fairness.

DEVELOPING OUR PEOPLE

Effective leadership is the hallmark of any successful organization. Developing our future leaders is a job we take seriously. We've developed innovative training programs that help employees improve skills in their present jobs. We're also helping them prepare to meet the challenges of tomorrow — as technicians, supervisors, postmasters and executives. All of our training emphasizes accountability and integrity. Skills are important, but values are at the heart of our brand.

SAFEGUARDING OUR EMPLOYEES

Maintaining a safe and secure workplace means that our employees can perform at their best for our customers. It's the right thing to do. And management compensation is tied, in part, to safety performance. This encourages them to bring the greatest focus possible to safe work practices, safe equipment and safe facilities.

The safety of our employees was challenged as never before when the mail was used as a vehicle for bioterrorist attacks. Working with the foremost public health officials in the nation, the Postal Service implemented an aggressive and far-reaching program to protect our employees, our customers and the mail. Leaders of our employee unions and management associations were actively involved in our efforts, which involved education, prevention, intervention and investigation.

...ONE NATION...

united we stand with **CUSTOMERS**

EXFC externally measures collection box to mailbox delivery performance. EXFC continuously tests a panel of 463 ZIP Code areas on the basis of geographic and volume density from which 90% of First-Class volume originates and 80% destinates. EXFC is not a system-wide measurement of all First-Class Mail performance.

In 2001, the Postal Service processed and delivered over 207 billion pieces of mail to a delivery network that grew by 1.7 million new addresses. We accomplished this with fewer employees and fewer work hours than last year. We managed to cut our costs by $900 million while maintaining the record service performance and high levels of customer satisfaction.

EARNING YOUR TRUST

Your trust is important to us. So, we make it our business to earn that trust with consistent on-time delivery. External First-Class Mail (EXFC) delivery scores, independently recorded by PricewaterhouseCoopers, showed that 94% of First-Class Mail destined for next-day delivery received overnight service, maintaining record performance for a second straight year.

Customer satisfaction measurements showed that 92% of households surveyed maintain a positive view of the Postal Service, rating their level of satisfaction as "good," "very good," or "excellent."

ADDING CONVENIENCE WITH SHIPPING TOOLS

The Shipping Center at www.usps.com enables customers to print Priority Mail with Delivery Confirmation shipping labels right from their home or office computer.

Customers can choose from domestic and international shipping options for speed, economy and value, order shipping supplies and, using Web Tools, find the best ways to ship efficiently.

MAKING MOVING EASIER

We didn't overlook the individual mailer, either. We've made moving easier for the 40 million Americans who change residences each year with Internet Change-of-Address (ICOA) service. Customers can complete and submit their change-of-address form online. ICOA is an enhancement to the MoversNet™ site on www.usps.com, which allowed customers to print, complete and submit the form to a Post Office. The enhancement reduces the costs of manually processing these forms and improves address quality. Net result? Better service.

BREAKING DOWN BARRIERS

We translated into Spanish and Chinese the top 10 forms most commonly used by our customers such as Certified Mail, Insured Mail and Money Orders. The change will help reduce long lines and increase business among minorities.

...UNDER GOD...

united we stand with LEGISLATORS

At the request of Congress and the Comptroller General, we are preparing a comprehensive transformation plan — to help shape the future of the Postal Service.

BLUEPRINT FOR OUR FUTURE

The plan will identify actions to help us manage more effectively and better serve the nation. It will also look at potential moderate legislative changes to provide us with better tools to meet the needs of our customers. And it will identify the long-term, comprehensive changes that will define and support the role of the Postal Service well into the 21st century.

To help guide the plan's creation, we have asked for input from our primary stakeholders — Congress, mailers, the Postal Rate Commission, and our employee unions and management associations. Moreover, we requested input via Federal Register notice.

We have also issued *An Outline for Discussion: Concepts for Postal Transformation.* It takes a fresh look at our options, challenges and opportunities, helping stakeholders to offer well-informed input. It's posted on our website, www.usps.com/strategicdirection. We expect to issue the plan in March 2002.

LEGISLATIVE ACTIVITY

The 106th Congress passed the 2001 Treasury/Postal Appropriations bill. It provided $96 million to reimburse the Postal Service Fund for free and reduced-rate mail. Of that, $67 million provides free mail for the blind and overseas voters. The bill reduced federal and postal employee retirement contributions by 0.4% and allows them to contribute an additional 1% annually to the Thrift Savings Plan, with a maximum of 10% for Civil Service Retirement System employees and 15% for Federal Employees Retirement System employees.

The Congress passed and the President signed the 2002 appropriations to fund free and reduced-rate mail. The Treasury, Postal Service and General Government Appropriations Act, Public Law 107-67, provides $76.6 million funding for this mail, with approximately $47.6 million deferred until October 1, 2002. It provides for continued free mail for the blind and overseas voters.

The Act extends the Breast Cancer Research stamp through 2003; requires the issuance of a semipostal stamp (a stamp used to raise funds in support of a designated cause or charity) in 2002 to aid families of emergency relief workers killed or permanently disabled while on duty as a result of the September 11 terrorist attacks against our nation; requires the issuance of a semipostal stamp to help fund programs against domestic violence; and continues air transportation of baby chicks as mail.

...INDIVISIBLE...

united we stand with THE MAILING INDUSTRY

The mailing industry is vital to our nation's infrastructure. This roughly $900 billion industry — which employs nine million people and accounts for 8% of the gross domestic product — is constantly being reshaped by an ever-changing marketplace.

To enhance the value of the mail as a primary communications tool, the Postal Service and leaders in the mailing industry jointly brought together an executive-level group that would provide recommendations for a course of action to enhance the mailing industry's ability to compete and thrive in the future.

MAILING INDUSTRY TASK FORCE

Deputy Postmaster General John Nolan and Pitney Bowes Chairman and CEO Michael Critelli co-chaired the Mailing Industry Task Force — a committee brought together to assess the current role and value of hard copy mail in business and consumer communications, evaluate the competitive environment affecting the industry's future and identify opportunities for future growth.

The Mailing Industry Task Force developed eight key recommendations. Among its suggestions is the creation of "intelligent mail" wherein a unique, digital stamp for each piece of mail would make it possible to track and trace mail. The results would be improved processing and delivery performance as well as added security.

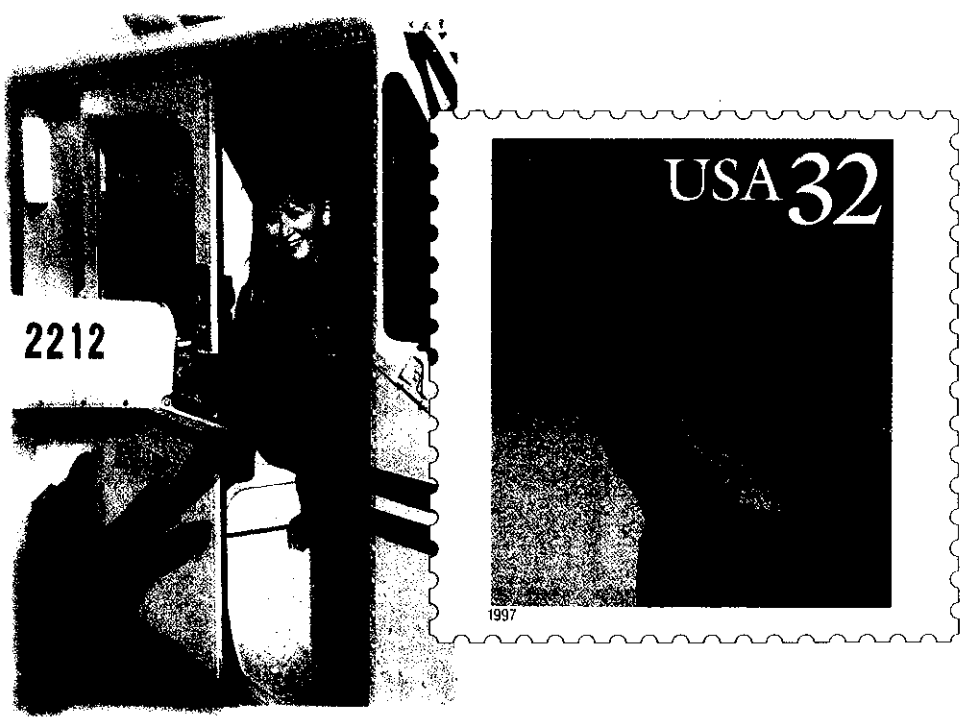
Other recommendations include development of enhanced consumer services, more efficient payment systems and alternative credit terms, mail preparation standardization, network optimization, a competitive pricing strategy, improved address quality and creation of an industry council.

The recommendations support strategic imperatives to respond to customer needs, make mail more competitive and unify the industry. The task force's research demonstrated that a nearly one trillion dollar industry of postal services and mailing service providers has been built around mail and its delivery.

This fact, noted co-chair Critelli, "underscores the role of the mail as an economic engine, and the need to ensure its good health."

The full report of the task force is available at www.usps.com.

...WITH LIBERTY...



united we stand with AMERICAN BUSINESSES

Attracting new customers — and keeping them — is a never-ending challenge for small business owners. So when a survey conducted by Millward Brown found small business owners were eager for easier, more cost-effective means of attracting new customers, we knew we could help.

SMALL BUSINESS TOOLS

We packaged our most sought-after online resources and tucked them under one, easily accessible umbrella, the Small Business Tools web page, available at our website, www.usps.com. The Small Business Tools suite of services helps small business owners gain new customers and offers tips and strategies to help keep those customers coming back.

A Direct Mail package helps business owners create direct mail campaigns that deliver a focused message right to the front door of prospective customers. A downloadable Direct Mail guide shows them how. Web Tools also contains links to mailing services such as list brokers and printers, and templates of brochures, envelopes and letters.

NetPost Mailing Online™ helps business owners design their own printed letters, self-mailers, invoices, newsletters and postcards. We do the rest, working from the electronic file to print, assemble and mail a completed product.

NetPost CardStore™ helps small business owners create customized advertising in minutes, using an array of designs, fonts and colors. Users can incorporate their own photo, logo or artwork for a completely customized look. The personalized cards are printed and mailed the next business day.

Capturing the attention of prospective customers is so much easier with the right tools. Whether it's guiding small business owners to prospective customers or helping them create and mail professional direct mail pieces, the Small Business Tools suite of services is both cost-effective and efficient.

OPENING A WINDOW TO OUR OPERATIONS

Large business mailers can now track their mailings in near real-time with Confirm®, our new service that uses PLANET CODE® technology to identify the mailer and store information about the mailpiece using a unique bar code. The encoded data is captured when the mailpiece passes through our sorting equipment, then it's transmitted to the mailer's computer or our Track and Confirm website at www.usps.com.

Confirm brings mailers one step closer to knowing where their mail is at any time. And it gives our operations managers the information they need to isolate and resolve problems, helping us to improve service to our customers.

...AND JUSTICE...

united we stand with AMERICA

At the Postal Service, we have learned that if you want to send a mighty message, you must wield a mighty tool. For more than 60 years, the Postal Service has helped raise awareness of important social causes through the issuance of tiny, yet powerful, postage stamps.

HELPING TO FIND A CURE

In 1998, we issued our nation's first semi-postal stamp, the Breast Cancer Research stamp. It was created to call attention to and help find a cure for a disease that threatens the lives of hundreds of thousands of women and men each year — breast cancer. The net proceeds of this stamp above the cost of postage are earmarked for research. It's a cause we are proud to champion.

Three years of sales have raised a net $22.3 million in voluntary contributions, with about $5.5 million of this amount being raised in 2001. Costs recovered to date total approximately $650,000. We expect to continue this effort since Congress has extended the sales period of the stamps for an additional two years.

The Breast Cancer Research stamp is valid as postage at the current First-Class rate. It sells for 40 cents with up to 6 cents per stamp going to designated research organizations — the National Institutes of Health and the Medical Program of the Department of Defense.

THE LOVING ACT OF ADOPTION

Each year, we honor a company or organization that uses the mail and works closely with postal employees to increase awareness of an important social issue. This year's honoree, the Dave Thomas Foundation for Adoption, was recognized for using the Adoption Awareness postage stamp to highlight adoption.

Founded by Wendy's restaurant owner, Dave Thomas, the Foundation's commitment to adoption extends far beyond the borders of everyday business and into the hearts and lives of people. With its goal of making adoption work for children and parents, the foundation serves as an active voice for more than 122,000 children who are in the child welfare system. Its mission is clear: "Every child will have a permanent home and loving family."

KNOW MORE ABOUT DIABETES

Diabetes is the leading cause of blindness, amputation, heart attack, stroke and kidney failure in both adults and children. It accounts for more than $105 billion of annual U.S. health care costs. It is a devastating disease for which there is no cure. But there is hope — through research and awareness.

We're doing our part to encourage diabetes education and research sponsorship with the issuance of the Diabetes Awareness postage stamp. It serves as the focal point of our year-long diabetes awareness campaign, established with assistance from the Juvenile Diabetes Research Foundation International, the American Diabetes Association, the National Institutes of Health, the Centers for Disease Control and Prevention and the American Association of Diabetes Educators. Together, we're working to turn hope into reality.

...FOR ALL.

the BOARD of GOVERNORS

The Postal Service Board of Governors is composed of 11 individuals, nine of them appointed by the President of the United States, with the advice and consent of the U.S. Senate. In turn, the Governors select the Postmaster General and, along with the Postmaster General, select the Deputy Postmaster General, both of whom also serve on the Board.

The Board of Governors is comparable to the Board of Directors of a publicly owned corporation. The Board directs and controls the expenditures of the Postal Service, joins in long-range planning and reviews the practices and policies of the Postal Service. Many of these activities are coordinated through the various committees of the Board.

Also members of the Board of Governors:

JOHN E. POTTER

Appointed 72nd Postmaster General and Chief Executive Officer of the United States Postal Service in June 2001. Potter has served as Chief Operating Officer and Executive Vice President, Senior Vice President, Operations; Senior Vice President, Labor Relations; and Manager, Capital Metro Operations.

JOHN NOLAN

Appointed 17th Deputy Postmaster General in February 2000. Nolan has served as General Manager and Postmaster for New York, Director of Operations for Merrill Lynch Production Technologies; Executive Board, National Postal Policy Council and the Mailers Council.

NED R. McWHERTER

Appointed October 1995, term expires December 2002. Member, Audit and Finance Committee. Former Governor for the State of Tennessee and Speaker, Tennessee House of Representatives; Officer and director of numerous companies in the transportation, financial, distribution, energy and health care industries.

ALAN C. KESSLER

Appointed November 2000, term expires December 2008. Member, Capital Projects Committee. Attorney and entrepreneur; Member, Board of Directors of Philadelphia Industrial Development Corporation; Partner, Wolf, Block, Schorr and Solis-Cohen, LLP; Chairman, Pennsylvania Supreme Court Continuing Legal Education Board.

ROBERT F. RIDER, CHAIRMAN

Appointed May 1995, term expires December 2004. Member, Strategic Planning Committee. Chairman and CEO, O.A. Newton & Son; Trustee, University of Delaware; Director of numerous companies and institutions.

ERNESTA BALLARD

Appointed November 1997, term expires December 2005. Chairman, Audit and Finance Committee. President and founder of Ballard & Associates; Board member, Ketchikan General Hospital, LifeCenter Northwest and Alaska Forest Association.

EINAR V. DYHRKOPP

Appointed November 1993, term expires December 2001. Member, Audit and Finance Committee. President of Tecumseh International Corporation; Regional Advisory Board member of the Southern Illinois University Public Policy Institute.

S. DAVID FINEMAN, VICE CHAIRMAN

Appointed May 1995, term expires December 2003. Vice Chairman, Strategic Planning Committee. President, Fineman & Bach, P.C.; Member, Industry Policy Advisory Committee to the U.S. Secretary of Commerce; U.S. Trade Representative on international trade policy.

LEGREE S. DANIELS

Appointed August 1990 and reappointed November 1999, term expires December 2007. Member, Capital Projects Committee. Former Assistant Secretary for Civil Rights, U.S. Department of Education; Member, Board of Directors, Center for International Private Enterprise and the Heinz Center.

TIRSO DEL JUNCO, M.D.

Appointed July 1986, term expired December 2000. Served through 2001 on one-year extension. Member, Strategic Planning Committee. Surgeon; founder and Chairman, Los Angeles National Bank; President, Board of Trustees of the Queen of Angels Hospital Clinic and Research Foundation.

JOHN F. WALSH

Appointed November 1999, term expires December 2006. Chairman, Capital Projects Committee. Former President, Ninth Square Association and Deputy Controller and Purchasing Agent for the City of New Haven, Connecticut; Member, Board of Directors, Greater New Haven Chamber of Commerce.

from the AUDIT and FINANCE COMMITTEE

Chairman's letter

The Audit and Finance Committee assists the full Board of Governors in fulfilling its fiduciary requirements. The Chairman of the Board of Governors selects the members of the Committee for each calendar year. This year, the Committee, whose members are Governors Dyhrkopp, McWherter and I, met ten times in conjunction with the regularly scheduled monthly Board meetings.

In 2001, the Audit and Finance Committee's responsibilities were expanded to include oversight of postal rate case development, cash management and financial performance. The Committee's other responsibilities, on behalf of the Board of Governors, include oversight of the financial reporting process, the soundness of the internal accounting and control practices and the integrity of the financial statements, as well as postal rate case development, cash management and overall financial performance. The Committee also recommends to the Board of Governors the selection of the independent certified public accounting firm responsible for the external audit work and oversees compliance with the terms of the contract.

During 2001, the Committee focused on both market and economic uncertainty. We recommended actions to maximize our liquidity and cash management flexibility and to minimize issuance of new debt. The more significant actions taken include a new rate case and a capital spending freeze.

We have reviewed and approved the scope of work for the 2001 financial statement audit. We have met jointly and independently with Ernst & Young, LLP, the Inspector General, management and the General Counsel to discuss the progress of the audit. We have ensured independence and objectivity in the OIG and external audit programs.

Accordingly, the Committee recommended, and the Board approved, the financial statements for 2001.

Ernesta Ballard,
Chairman, Audit and Finance Committee
December 3, 2001

FINANCIAL section

OVERVIEW

In this section we discuss our finances, including the successes we had, the challenges we face, our plan for the future and the risks that lie ahead. If we were a private sector company seeking profit and return to shareholders, the financial analysis of our results would focus primarily on our bottom line, which this year is a loss of $1.7 billion. However, we are an "independent establishment of the executive branch" wholly owned by the U.S. government and its citizens. Our financial goal is to cover costs through revenue generated by the services we provide. This year your Postal Service responded to significant financial challenges, lower than expected revenue and rapidly increasing personnel and benefits costs. While continuing to increase the universal delivery network with an additional 1.7 million addresses, we reduced career employment by over 11,500. The result was a level of productivity that averted what could have been a much greater loss.

Our universal service mandate means we deliver to everyone, everywhere, and we do not charge whenever we add a new delivery address. To meet this increased demand, we need to invest approximately $600 million in new facility space each year, beyond the cost of replacement facilities. Not making these investments each year can, over time, affect our ability to fulfill our universal service mandate. When our competitors' fuel and other costs increased, they immediately increased their prices. When our fuel and other costs increased, we immediately prepared a request for a rate increase, and began a process that can take up to 18 months before our prices change. Thus, while the statute under which we operate requires us to provide universal service, it does not give us the ability to quickly change our rates whenever our costs go up or down. Nevertheless, the Postal Service maintained service, reduced costs and minimized the financial loss in 2001.

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a message from the CHIEF FINANCIAL OFFICER

This has been a year of challenge. It has been a year of success. It has been a year of change.

The Postal Service faced the challenge of improving performance above previous levels. We faced the challenge of expanding to serve an ever-growing nation. And we faced the significant challenges of a changing economy, a cumbersome rate-setting process and the aftermath of the September 11 terrorist attacks.

I am pleased to report that the Postal Service met these challenges. We delivered high levels of service. We improved the workplace environment. We set new records for efficiency in operations. At the same time, aggressive and successful cost management efforts limited our net loss to $1.7 billion, down significantly from a figure that could have reached $3 billion.

While the Postal Service raised rates this year, those rates reflected economic assumptions that were developed some two years earlier, consistent with an extremely lengthy statutory rate process. However, after we filed our rate request in early 2000, we were faced with a number of unexpected economic events.

One of these was unusually high inflationary pressure on labor costs. The cost per work hour increased by 5.8% in 2001, exceeding the 4.8% increase of 2000. In addition, a downturn in the economy affected growth in mail volume and revenue. Against this backdrop, the independent Postal Rate Commission failed to recognize the need for the level of contingency funds included in the rate case filed in 2000. The rate process itself prevented full implementation of new rates before the last quarter of the fiscal year. These factors, combined, produced the year's loss of $1.7 billion.

Managing costs and improving service have become watchwords in the Postal Service, and they exist comfortably side by side. Last year we extended delivery to 1.7 million new addresses. We did that while we reduced the number of career employees by over 11,500, and saved 23.1 million work hours. This drove a productivity gain of 1.3%, with allied cost savings of $900 million. At the same time, we achieved record levels of customer satisfaction and quality service.

When we recognized that the economy was changing, we put a temporary hold on more than 800 capital facility projects nationwide. At headquarters, we instituted a hiring freeze and reduced programs. Other actions were taken in administrative functions throughout the organization. Without these efforts, our net loss for the year could have reached $3 billion.

And we will not stop there. Over the next year, we will continue our work to increase productivity and cut expenses. We will take $2.2 billion in additional costs from our system while we cut 25,000 more work years. Despite these actions, we face a loss in 2002 that will exceed this year's.

Looking ahead, we filed a rate case to meet our needs for additional revenue in 2003. Our proposals incorporate a modest contingency provision of 3% of total projected costs for 2003. This amount, falling within the accepted historical range for contingency provisions, must serve as a cushion against unforeseen events. However, it may not be adequate in light of the dramatic events that have occurred since September 11.

Clearly, the rate-setting mechanisms available within our existing statutory framework fall short of what is needed to provide quality, secure mail service in an uncertain future. This inadequacy, combined with the delay inherent in the rate-making process, will continue to impede our ability to restore the Postal Service to a position of robust financial health.

We face a future that has been forever changed. We face unprecedented uncertainty. We face attacks on the mail that seek to cripple this essential conduit of American ideas and commerce. But we will stand strong and united against those who would stop us from our historic mission of binding the nation together. They have underestimated the resolve, the capabilities and the dedication of our employees.

We will continue to do all we can to protect the financial health of this great organization. From Maine to Hawaii, from Alaska to Puerto Rico, we will continue to deliver for America.

Richard J. Strasser, Jr.
Chief Financial Officer
and Executive Vice President
November 9, 2001

MANAGEMENT DISCUSSION & ANALYSIS: OUTLOOK

2001 proved to be a very challenging year for the Postal Service. A softening economy and inflationary increases in our costs put severe pressures on our financial performance. Even our extraordinary productivity performance, which limited cost growth, was insufficient to offset these negative forces. We expect 2002 to be even more challenging. There is greater economic uncertainty today, and we face the challenges of maintaining service and improving productivity in the wake of terrorist attacks that use the mail as a delivery mechanism.

The U.S. economy had entered a recession even before the terrorist attacks of September. Over and above their human cost, these atrocities are causing a significant short-term dislocation to the economy, adding still more uncertainty to our view of the future. Layoffs and unemployment are rising, and much of the wealth generated by the long bull market has disappeared. In 2002, we are concerned that even if the recession is short, stagnation or slow economic growth will follow.

An additional hazard that primarily affects the Postal Service is the continued threat from attacks such as those that spread anthrax bacteria late in 2001. In response to these threats, we are working to ensure the safety and security of the mail.

Although inflation is moderating as a result of a weakening economy, it is uncertain whether the Postal Service will experience any substantial benefit. Our labor costs have grown very rapidly in recent years, with increases in salaries and health benefits outpacing the Employment Cost Index (ECI), partly as a result of arbitration decisions that awarded substantial wage increases to some craft employees. This growth has occurred despite the reductions in total work years we achieved in each of the past two years. Health benefits expenses have grown at double-digit rates. With three more arbitration decisions due in the coming year, there is significant uncertainty about labor costs. Also a growing share of Postal Service expense relates to retirement benefits that increase with the passage of time.

Because our price for labor is increasing faster than inflation, we will not be able to meet our goal of keeping rate increases less than inflation in the near term. In each of the last three rate cases (R94-1, R97-1, and R2000-1), the average price increase was less than inflation, with a cumulative price increase of about 21%, compared to inflation of nearly 32%. The proposed rates for the R2001-1 filing, however, represent an average increase of 8.7%, against an expected inflation of less than 4%.

As volume growth slows, it is difficult to keep rate increases below the rate of inflation because the revenue earned from that volume must not only cover the cost of those volumes but must also cover the costs of a growing delivery system. Furthermore, in recent years, mail volume growth has not kept pace with the economy.

Every year we deliver to about 1.7 million new addresses, as the number of addresses we are obligated to serve continues to grow. Neither population growth nor the rate of household formation has slowed. New housing continues to be built, with new addresses that need mail delivery service. As we try to cut costs, annual address growth requires the equivalent of us adding over 3,000 new carrier routes. Operating these routes requires hiring more carriers, purchasing new vehicles and equipment and building new facilities to serve the growing delivery network.

At the same time that labor costs are rising, we face the prospect of slow mail volume growth. The diversion of First-Class Mail and Standard Mail to electronic alternatives is gradually diverting volume from the mail stream, and we expect this to continue. Internet-based bill payment systems are well established, and we expect more consumers to opt for electronic bill payment for at least some of their bills. As electronic bill payment becomes more popular, it seems likely that the number of bills presented to consumers electronically will also grow. We expect First-Class Mail volume growth to remain sluggish, a result of economic conditions and the increasing market share of alternative bill presentment and payment technologies.

The economic slowdown will affect Standard Mail. Most observers see declining growth in the ad market in the near future, an effect of generally poor economic conditions. Since Standard Mail is frequently part of a multifaceted advertising campaign, shrinking advertising budgets will impact volume and revenue. In the long term, the prospects for Standard Mail volume growth are favorable. The fact that Standard Mail is a highly targetable medium works in its favor, because resources can be used to reach a very specific audience, rather than having a message broadcast to many uninterested parties.

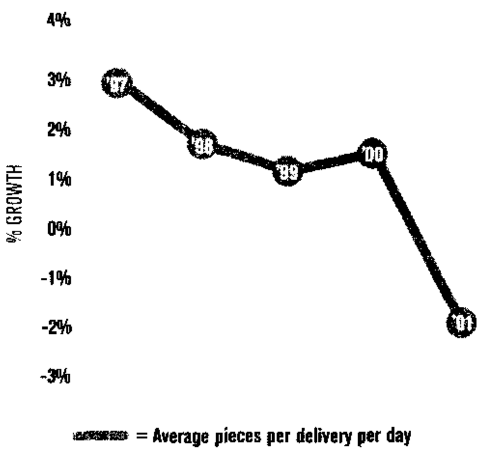
The end result of slowing volume growth and continuing network expansion is a declining number of pieces per delivery and a cost per delivery that rises. To combat this growing inequality, we must continue to manage our costs and use less resources to increase productivity. Over the last two years, we have increased our productivity by streamlining our processes and weeding out costs. Even so, our accumulated losses are growing, and our debt is increasing. In the wake of the anthrax attacks, we are assessing the need to invest in new equipment to ensure the security of the mail. The ultimate cost of this investment remains unclear, but it could be significant, and unless funded by appropriations from Congress, it compounds our problems.

In the face of these trends, we have frozen capital spending on facilities and other infrastructure projects not related to safety and security. This freeze will have negative impacts. We need investments in facilities and infrastructure to maintain our network and fulfill our obligations to our customers. We need to purchase new equipment and buildings to service new addresses, and we need to be able to maintain, repair and replace existing infrastructure to continue serving our customers.

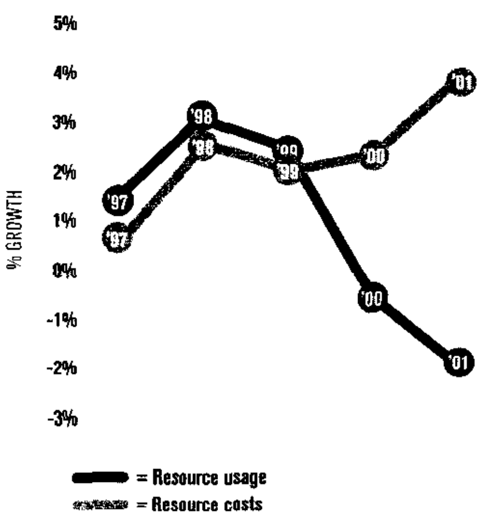
Our challenge is to build our business and keep improving productivity through control of our costs, while ensuring our long-term ability to continue providing high-quality service. This may include not only filing rate cases but also seeking a broader reform of the legislation that guides the Postal Service to give it more flexibility in the marketplace and more control over costs.

Our discussion in the MD&A represents our best estimate of the trends we know about, the trends we anticipate and the trends that we think are relevant to our future operations. However, actual results may be different from our estimates.

Volume Growth per Delivery Declines...



...While Resource Costs Keep Rising Despite Controlling Resource Usage



Source: Christensen Associates, Inc. Productivity Data

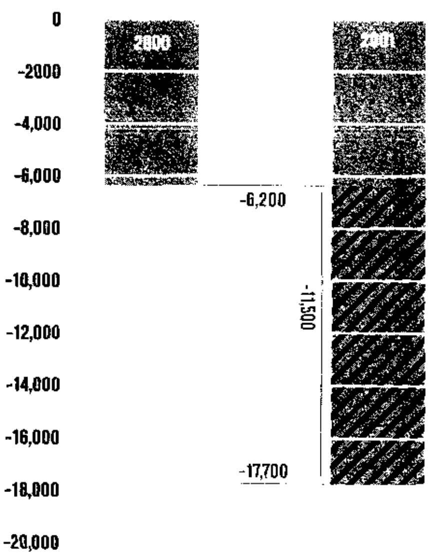
MD&A: OPERATIONS

Net (Loss) Income

$ millions

2001	2000	1999
($1,680)	($199)	$363

In the Last Two Years, We Reduced Our Cumulative Work Years...



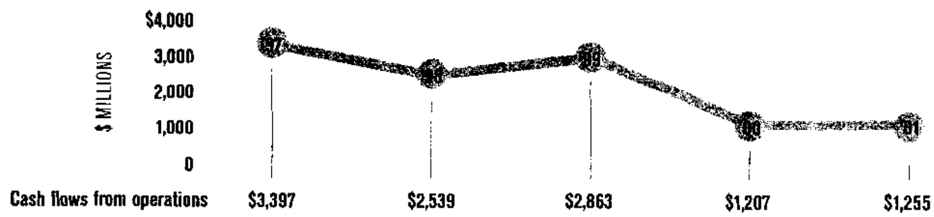
...Even As We Delivered 6 Billion More Mail Pieces and Added 3.6 Million Delivery Points

Financial Review

The financial bottom line for 2001 is a net loss of $1.7 billion. This follows the loss of $199 million in 2000. The trend and its implication, though, is clear: our cash flow from operations is declining.

This trend has two component parts: first, a declining growth rate for revenue and volume, and second, a trend of increasing labor cost per hour. Each of these components is discussed in the following sections. The graph above shows the result of this trend: a decline in the net cash provided by operations. This cash is critical to financing our capital expenditures, those necessary to substitute capital for labor as well as those expenditures we need to make to maintain universal delivery service. Declining cash flow makes it harder for us to provide the infrastructure that supports our universal service mandate, as well as to increase productivity. Our financing of those investments is discussed later in our Capital Investment and Financing section.

Net Cash Provided By Operations



When we prepared our 2001 financial plan in the summer of 2000, we projected revenue would increase in 2001 by $4.0 billion. We later reduced it by $630 million, recognizing the trends that emerged at the end of 2000. Our forecast expense then exceeded our revenue, and a net loss of $480 million was projected. The growth in expenses was fueled by an increase in cost per labor hour of almost 6%. It was driven by rising Cost of Living Adjustments (COLA) tied to the Consumer Price Index (CPI), higher level pay for letter carriers, and inflation of 11% in health benefits. Several other factors occurred after this plan was set that changed the actual outcome even more dramatically.

The first was the Postal Rate Commission's (PRC) recommended decision to reduce the contingency amount in our rate request. This contingency is to cover unforeseen events. The total effect of the PRC decision was to reduce revenue generated by recommended rates and fees by approximately $1 billion. Effective July 1, the Governors modified the rates recommended by the Postal Rate Commission, but the delay in implementing rates reduced revenue by $400 million.

The second factor was the economic slowdown and competition, which restrained volume late in 2000. In early 2001, based on new forecasts and projected costs, we were facing a loss of between $2 and 3 billion. We immediately acted to reduce expenses and accelerated the work year reduction begun in 2000. In addition, we established a headquarters-hiring freeze, removed an additional $300 million from program budgets and implemented a capital spending freeze due to cash flow concerns.

The third factor was the terrorist attacks of September 11, which dramatically reduced mail volume in the last days of the fiscal year and cut revenue by approximately $200 million. We did accomplish our objective of work hour reductions, a record-setting 23 million hours below 2000. We controlled expense growth in spite of higher labor costs, higher fuel and utility prices and rising health benefits costs. Without these actions, our loss for the year would have been greater.

Operating Revenue

In last year's report we projected a 5% growth in revenue for 2001, anticipating the requested rate increase and a forecast of modest volume growth. However, the entire process for this rate request — starting with preparing the necessary documentation to support the rate proposals and ending with implementing the new rates — took two years. During that time, economic conditions began to change for the worse. Revenue grew by only $1.3 billion from 2000 to 2001. This was $2.1 billion less than we planned. The slowdown in the economy and the September 11 attacks accounted for $1.5 billion of this difference, while $400 million was a result of the Postal Rate Commission's recommended decision, and $200 million resulted from shortfalls in our revenue initiatives.

The changing characteristics of the mail also affects our revenue. Across almost all however, the decline is likely due to rate increases that hit the higher weight steps especially hard, as well as actions by our competitors to secure some of the volume in the wake of the rate increases. At the same time, differences in growth rates between classes of mail are changing the mail mix. More and more mailers are taking advantage of presort and drop-shipping discounts, which affect our revenue and workload.

Operating Revenue

Year	Operating Revenue	Increase Over Previous Year	Increase Over Previous Year
2001	**$65.8 billion**	**$1.3 billion**	**2.0%**
2000	$64.5 billion	$1.8 billion	2.9%
1999	$62.7 billion	$2.6 billion	4.4%

classes of mail, average weight per piece was down in 2001. This trend is most pronounced in Periodicals, Express Mail® and Parcel Post®. All of these classes declined well over 5% in weight per piece since the rate change in January 2001. In the case of Periodicals Mail, the weight decline is largely due to the economic slowdown and consequent weakness in the advertising market. For Express Mail and Parcel Post,

Overall, total mail volume declined by 420 million pieces, or 0.2% from last year. First-Class Mail grew only 0.1% in 2001, the lowest growth since the recession of 1991. Growth in the presort categories did not offset a 2.7% decline in single piece First-Class volume. Standard Mail lost 0.1% or 119 million pieces this year. Mail continues to move into the automation presort from the nonautomation categories.

Fortune Magazine's Global 500 Would Rank the Postal Service the Eleventh Largest Company in the Country

FORTUNE 500 RANK	Company	2000 Revenue ($ millions)
1	Exxon Mobil	210,392
2	Wal-Mart Stores	193,295
3	General Motors	184,632
4	Ford Motor	180,598
5	General Electric	129,853
6	Citigroup	111,826
7	Enron	100,789
8	International Business Machines	88,396
9	AT&T	65,981
10	Verizon Communications	64,707
11	**United States Postal Service**	**64,540**
12	Philip Morris	63,276
13	J.P. Morgan Chase	60,065
14	Bank of America Corporation	54,747
15	SBC Communications	51,476

Growth in Revenue and Volume

	REVENUE			VOLUME		
	2001	2000	1999	**2001**	2000	1999
First-Class Mail	**1.0%**	1.7%	3.2%	**0.1%**	1.6%	1.5%
Standard Mail	**3.4%**	5.2%	5.4%	**-0.1%**	5.1%	3.8%
Priority Mail	**1.6%**	6.7%	8.3%	**-8.6%**	2.8%	1.3%
Package Services	**4.3%**	4.6%	4.2%	**-3.1%**	8.2%	1.9%
Periodical Mail	**1.6%**	2.6%	2.1%	**-2.8%**	0.9%	-0.4%
International Mail	**4.5%**	1.8%	1.8%	**-1.5%**	6.7%	9.2%
TOTAL MAIL	**1.8%**	1.7%	3.2%	**-0.2%**	1.6%	1.5%

The Rate of Growth of Our Revenue Continues to Decline.

For the first time since 1991, our mail volume declined, jeopardizing our ability to fund our universal service mandate.

Priority Mail volume fell 8.6% this year, driven primarily by a 15% average price increase beginning in January. Priority Mail is part of the extremely competitive expedited package market and is also affected by economic conditions. Total Package Services declined by 3.1%, although the Parcel Post component grew strongly, at 9.4%. Most of this growth came from bulk-entry products, with some retail Priority Mail moving down to Parcel Post. Also declining this year were Periodicals, down by 2.8% and International Mail by 1.5%.

In past years, we have presented forecasts for the various classes of mail in this section. However, economic and operational uncertainties as to the full effect of the terrorist attacks precludes that this year.

Rate-Making Activity

Until 1971, Congress set postage rates through legislation, and the relationship between the revenue from those rates and the actual cost of operating the postal system varied greatly. Since 1971, however, the Postal Reorganization Act has required the Postal Service to establish postal rates that cover the costs of operating the postal system.

The rate-making process is lengthy and complicated and begins when management determines that current rates will not be adequate to meet our mandate of "covering costs" in the future. The Postal Service, with approval of the Board of Governors, submits a request for a recommended decision on rate and fee changes to the Postal Rate Commission (PRC), an independent establishment of the executive branch of the government. The submission is accompanied by detailed rate proposals supported by extensive testimony and lengthy documentation.

The Commission's proceedings take up to 10 months. It holds public hearings, during which interested parties such as mailers, competitors and consumer representatives are authorized to challenge the Postal Service's proposals and submit their own testimony and proposals. At the conclusion of the hearings, the Commission sends its recommended decision to the Governors. The Governors may approve, reject, allow under protest, or, under certain limited circumstances after more proceedings, modify the Commission's recommendations.

Classification and Rate Changes

In November 2000, the Postal Rate Commission (PRC) issued its first Recommended Decision for R2000-1, reducing many of the rates requested. In the opinion of our Governors, the rates and fees that the PRC recommended would have resulted in a revenue shortfall of approximately $1 billion. After considering their statutory options, the Governors decided to allow the PRC recommendations to take effect "under protest" and to return the case to the PRC for reconsideration. As a result, we implemented the PRC's recommended average increase of 4.6% on January 7, 2001. In its second Recommended Decision, the PRC recommended limited changes that did not correct the projected revenue shortfall. Therefore, the Governors rejected this Decision and returned the case to the PRC for reconsideration once again.

When the PRC's third Recommended Decision did not correct the projected revenue shortfall, the Governors chose to "modify" the decision. Under the Postal Reorganization Act, the Governors must ensure that postal revenue is sufficient to cover total estimated costs. If the PRC recommends rates that are insufficient, the Governors may change or "modify" those rates to correct the revenue imbalance. Any decision by the Governors to modify a PRC decision must be unanimous. This is an unusual step, and for only the second time in 30 years the Governors found it necessary to modify a PRC recommended decision in an omnibus rate case. We implemented the modified rate increase of 1.6% on July 1, 2001.

Following an evaluation of the Postal Service's financial position, the Governors decided to file a new rate request with the PRC in September 2001. The proposed rate increase averages 8.7%. In light of the Postal Service's current financial requirements, the Governors requested that the PRC expeditiously act on the rate request and return a Recommended Decision in less than the 10 month maximum set by law.

Expenses

Compensation and Benefits

Our personnel compensation and benefits costs, including interest on deferred retirement, grew over $1.8 billion or 3.6% over 2000. This year's growth was due to contractual payments and health benefits, even though labor use was reduced by over 11,500 work years. This compares to growth of 4.4% in 2000 and 3.7% in 1999.

However, labor rates increased by 5.8% on a cost per hour basis. Base salaries alone increased more than $713 million in 2001. Contractual lump-sum payments increased by $495 million. Our health benefits expenses were $244 million greater than last year, driven mainly by premium increases per participant in January 2001 of 11% for active employees and 9% for annuitants and our increasing number of retirees. Due to the high cost of prescription drugs, advances in medical procedures and the aging of the American population, we expect our health benefits expense to continue to grow.

Growth in Compensation and Benefits

2001	2000	1999
3.6%	4.4%	3.7%

The September 1999 National Association of Letter Carriers (NALC) arbitration award provided for the upgrade of all letter carrier craft employees from their current Grade 5 classification to Grade 6 while maintaining the salary differential between Grade 5 and 6. The effective date of the upgrade was November 18, 2000, resulting in a cost of $267 million.

Compensation and Benefits Details ($ millions)

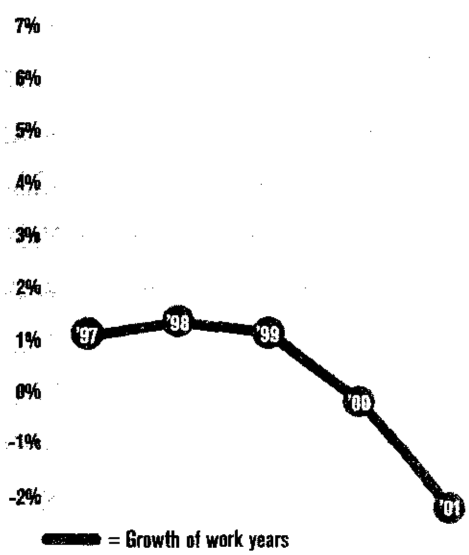
	2001	2000	Change	Percent Change
Compensation	**$37,924**	$36,981	$943	2.6%
Retirement	**8,885**	8,529	356	4.2%
Health Benefits	**2,365**	2,235	130	5.8%
Retirement Health Benefits	**858**	744	114	15.3%
Workers Compensation	**970**	911	59	6.5%
Other	**1,952**	1,700	252	14.8%
TOTAL COMPENSATION AND BENEFITS*	**$52,954**	$51,100	$1,854	3.6%

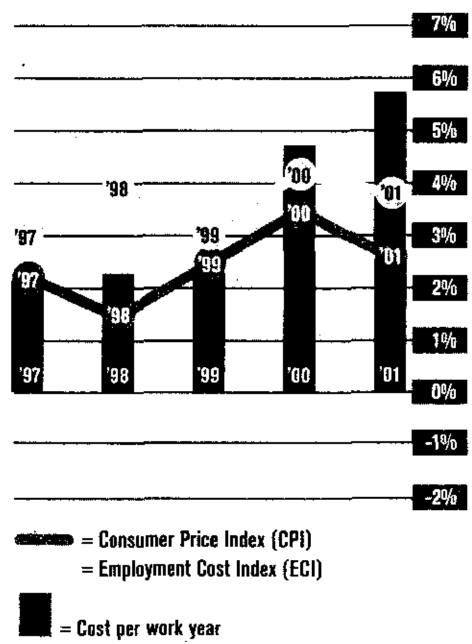
** Equals compensation and benefits plus interest on deferred retirement on the Financial Statements.*

Collective bargaining agreements with three of the four major postal unions expired in November 2000. Negotiations for new agreements were unsuccessful. The Postal Service and the American Postal Workers Union bypassed the fact finding and mediation phases of the dispute resolution process and began arbitration on August 27, 2001. The Postal Service and the National Rural Letter Carriers Association went through all three phases of the dispute resolution process, beginning with the fact finding on April 30, moving to mediation in June and, finally, arbitration on July 16, 2001. Negotiations continue with the National Postal Mailhandlers Union. And, for the National Association of Letter Carriers, whose contract expires in November 2001, negotiations are under way.

Non-bargaining Postal Service employees only receive increases in compensation through annual merit reviews. Unlike the rest of the federal government, these employees do not receive automatic salary increases, nor do they receive COLAs or locality pay. Additionally, lump-sum payments are made from the Pay for Performance program, a group incentive program covering over 84,000 supervisors, managers, postmasters, executives and staff throughout the Postal Service. To spur greater levels of performance in core areas, this incentive program sets measurable performance goals for the organization and for each organizational unit within the Postal Service at the beginning of each year. Participants in the program earn incentive credits through performance to these goals and as financial performance measures indicate that economic value has been added to the organization. Each year, employees earn incentive credits that are placed in a reserve account. One third of the total amount is paid, and the remainder is held in reserve and is placed "at risk," pending future performance. The objective of this approach is to promote continuous improvement and long-term value creation.

The Workforce Is Decreasing...





...But Labor Cost Per Work Year Accelerates Faster Than Inflation

Health Benefits

Our health benefits expenses were $244 million greater than last year. The cost of retiree health benefits now represents 27% of our total health benefits costs.

Retirement Expenses

Virtually all of our employees participate in one of three retirement programs, under the auspices of the federal government's Office of Personnel Management (OPM). (Please see Note 6 of the Notes to Financial Statements for details.) These three programs are the Civil Service Retirement System (CSRS), the Dual CSRS/Social Security System (Dual) and the Federal Employees Retirement System (FERS). Both the CSRS and the Dual systems are now closed to new participants, and all employees hired since 1983 participate in FERS.

Total retirement expense this year was $8.9 billion, an increase of $356 million or 4.2% compared to 2000. This follows increases of $428 million in 2000 and $405 million in 1999. Over $141 million of this year's increase is related to the FERS. Approximately $131 million of this year's increase was due to the Cost of Living Adjustments (COLA) for annuitants, increasing their benefits based on the Consumer Price Index (CPI) increases.

Workers' Compensation

Our employees are covered by the Federal Employees' Compensation Act (FECA), which is administered by the Department of Labor's Office of Workers' Compensation Programs. This office makes all decisions regarding eligibility for benefits for injured workers. Our bottom line is directly affected every time an employee is injured.

We record as a liability the present value of all the future payments we expect to make to those employees receiving workers' compensation. At the end of 2001, we estimate our total liability for future workers' compensation costs at $5,804 million, an increase of $244 million or 4.4% over 2000. For this year we had planned on workers' compensation costs of $998 million, basing our budget on trends that we expected to continue. In 2001, we recorded $970 million in workers' compensation expense, compared to the $911 million we recorded in 2000. (See Note 3 of the Notes to Financial Statements for details.)

Productivity

Productivity is a measure of our efficiency. While Total Factor Productivity (TFP) growth may fluctuate from year to year, over the long run, our goal is to have positive growth in productivity. During 2001, our TFP improved by 1.3%, which is equivalent to reducing expenses by nearly $900 million. Our two-year cumulative TFP growth of 3.7% is comparable to an expense reduction of more than $2.5 billion. Not since 1978 have we achieved TFP growth of this magnitude.

Global Bargain

	Price of First-Class Stamp
Australia	$0.24
Mexico	0.33
United States	**0.34**
Canada	0.36
Great Britain	0.38
France	0.41
Germany	0.50
Switzerland	0.54
Italy	0.55
Japan	0.65

Transportation

Transportation expenses increased by $347 million in 2001, driven by increased fuel prices and a change in how we report processing and transportation expenses associated with the Priority Mail Processing Centers (PMPC). In previous years this expense was included in the Other category. During the year, we terminated our contract with Emery Worldwide Airlines for the transportation of mail within the PMPC network and the operation of the PMPCs. The operations were brought in-house, and new transportation contracts were initiated.

Growth in Transportation Expenses

2001	2000	1999
7.4%	10.4%	1.4%

We made a number of changes that have saved money while improving our efficiency. Our Highway Contract Route reviews, which made our truck routes more efficient, and other efforts lowered our transportation costs by approximately $135 million.

We think that transportation costs for 2002 will remain in line with our costs for 2001, subject to adjustments required following the September 11 terrorist attacks.

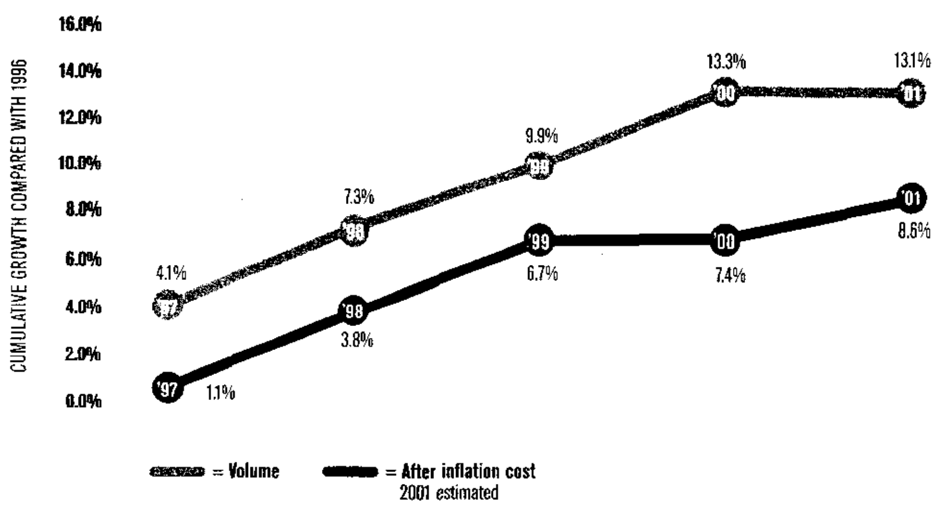
Expense Growth in 2002

We expect the cost pressures that made a major impact on our 2001 bottom line to continue. In 2001, we estimated that our total expenses would increase $3.1 billion in 2002. However, we intend to improve productivity by $900 million, reducing our estimated expense increase to $2.2 billion. Of this amount, $1.8 billion is for growth in personnel expenses, and $400 million is for non-personnel expenses.

Aside from pay increases, personnel costs will increase due to health benefits and retirement funding. Our planned reduction of 26 million work hours in 2002 will mark the third year in a row we will have reduced work hours compared to the prior year. In the non-personnel category, expense growth will be due mainly to increasing depreciation and interest expense.

The trends driving expense growth will continue. Therefore, our focus in 2002 will be on continuing to manage costs. As the chart below shows, our costs, adjusted for inflation, have risen more slowly than volume over the last five years because of our cost control measures. Not only has volume grown 13% cumulatively since 1996, but delivery points have increased by 5% as well, adding to the workload and cost of delivering the increased volume.

Cumulative Growth in Volume and Inflation-Adjusted Cost



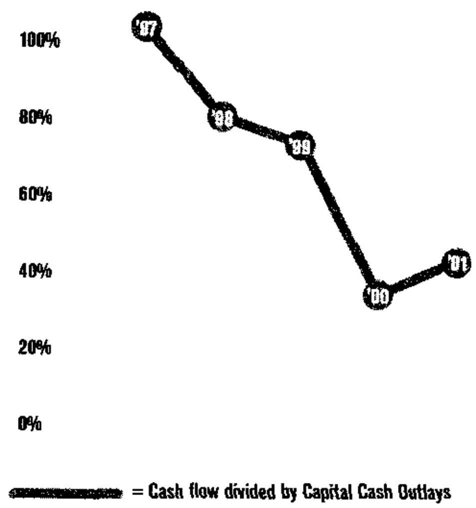
MD&A: CAPITAL INVESTMENT and FINANCING

Our capital investment and financing plans are interactive. There are four interlocking components: cash, cash flow from operations, capital cash outlays, and borrowing. A change in any one of the components causes a change in one or more of the others. For example, the amount we borrow over time is largely determined by the difference between our cash flow from operations and our capital cash outlays. Our capital cash outlays are the funds we invest in the business for such capital improvements as facilities, automation equipment and information technology. During the year, when it became apparent that our cash flow from operations was going to be significantly less than expected, we would have had to significantly increase our borrowing to make the capital investments we had planned. Instead, we took action to reduce our capital plan and cash outlays and stay within our borrowing plan. This is what led to the freeze on new facilities commitments.

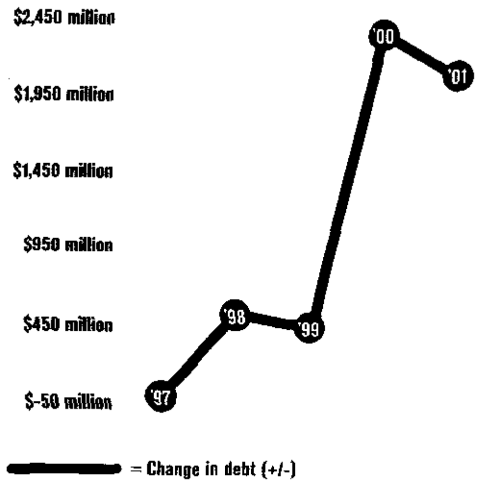
The Cash Flow/Capital Expenditure (CAPEX) ratio shows the relationship between these main drivers of our debt balance. It is computed by dividing cash flow from operations by capital cash outlays.

The graphs to the right illustrate the direct relationship between the CAPEX ratio and borrowing. Whenever capital spending exceeds cash flow, the difference must be paid for either by reducing cash on hand, borrowing or by some combination of the two. For example, in 2001, purchases of property and equipment of $2.9 billion exceeded our cash flow from operations of $1.3 billion, so we borrowed the difference while increasing our cash on hand at the end of the year by $322 million.

When the Cash Flow/Capital Expenditure Ratio Falls Below 100 Percent, We Cannot Pay For Capital With Internally Generated Funds...



...and Debt Increases Proportionally



Capital Freeze

Recognizing a slowdown in our cash flow from operations, we significantly reduced the capital commitments we had planned for 2001 in order to conserve cash and remain within our borrowing authority. Initially, we reduced our capital commitment budget from $3.6 billion to $1.6 billion, a total of $2 billion, as detailed in the table below. However, we ended the year with actual capital commitments of $1.2 billion as management further tightened the capital investment process. The actual commitments were spread across the following categories: approximately $450 million for mail processing equipment, $370 million for facility construction and building purchases and improvements, $220 million for postal support equipment and $110 million for retail equipment and vehicles.

We placed a temporary hold on capital contract awards, including over 800 facility projects nationwide. In addition, we reprioritized all capital projects and issued revised 2001 capital budgets. We assigned the highest priority to investments related to the safety of our employees and customers, legal requirements, emergencies and investments that produce labor efficiencies. We placed a freeze on all other facilities. We are monitoring the effects of this freeze, and we will make the necessary adjustments to ensure we meet our priorities.

Capital Investments

All major capital projects, generally defined as projects greater than $10 million, require authorization by the Board of Governors. At the beginning of the year there were 56 Board-approved projects in progress. During the year, 13 of these projects were completed and 11 new projects, totaling slightly over $500 million, were authorized. The table on page 29 shows the project authorization history and the commitment and capital cash outlays for the 54 Board-authorized projects active at the end of the year. While the funding for a project may be authorized in one year, the commitment, or contract to purchase or build the project, may occur over several years. In addition, the actual payment, or capital cash outlays, for the project may occur over several years. Thus, in the table on page 29, the $1.379 billion in capital outlays for 2001 represents outlays for commitments made in previous years as well as commitments made in 2001 for all 54 projects.

Management Aggressively Cut the Capital Plan By $2 Billion to Conserve Cash.

2001 Capital Investment Plan ($ millions)

Investment Category	Original	Revised	Difference
Facilities	$1,074	$569	$(505)
Mail Processing Equipment	1,497	507	(990)
Vehicles	266	49	(217)
Customer Service Equipment	246	76	(170)
Postal Support Equipment	559	400	(159)
Total Commitments	**$3,642**	**$1,601**	**$(2,041)**

Status of 54 Active Board-Approved Capital Projects at end of 2001 ($ millions)

	Authorizations	Commitments*	Outlays*
2001	$ 506	$ 593	$1,379
2000	1,580	1,509	702
1999	960	1,419	797
1998	1,014	564	319
1997 and earlier	2,435	858	213
Total	**$6,495**	**$4,943**	**$3,410**

**This table summarizes the Cash Outlays and Commitments made that year for each of the 54 active, Board-approved projects, regardless of the year in which the Board authorized the project.*

Future

Our capital plan for the future calls for aggressive cost management by developing and deploying new automation and mechanization equipment that will increase our operating efficiency. Under this plan, we will make significant investments in programs that reduce work hours in our distribution, processing and delivery operations. Additionally, there is uncertainty as to the cost of the equipment necessary to protect the mail and adjust delivery operations in response to terrorist attacks.

However, the capital plan is at extreme risk due to the 2002 financial condition of the Postal Service. Furthermore, we need to invest approximately $600 million in new facilities each year just to keep up with the growth in the universal delivery system. Each year we add about 1.7 million new delivery points, the equivalent of over 3,000 new carrier routes, requiring the space equivalent to approximately 100 new delivery facilities. Moreover, this growth is not spread evenly throughout the system but is concentrated in specific high-growth areas. While we will continue to plan for projects that will generate productivity improvements and increase revenue, for the second year in a row we will not be able to make the necessary capital investments to meet the growth demands of universal delivery.

Debt

From 1997 through 2001, our capital cash outlays exceeded cash flow from operations by $5.2 billion, so the difference was covered with borrowed funds. Our debt outstanding with the Department of the Treasury's Federal Financing Bank increased by $5.4 billion. Debt outstanding at the end of 2001 was $11.3 billion, an increase of $2 billion compared to 2000.

Normally, our debt balance at the end of our fiscal year represents our highest level of debt for the year because, while expenses for workers' compensation and retirement are accrued throughout the year, the actual payments are not made until late September of each year. The amount that we paid this year was $4.5 billion, including $694 million for workers' compensation and $3.8 billion for the Civil Service Retirement System (CSRS) and Cost of Living Adjustments (COLAs) for retirees. Our cash flow during the fiscal year was sufficiently strong to reduce debt from the prior year-end level. Debt outstanding reached a low of $4.6 billion on July 5. In other words, we had extinguished 50% of the debt that we had entering the year. Since we have debt financing flexibility, we can manage the fluctuations in our debt during the year by actively managing our credit lines. However, just as our debt balance at year-end has increased in recent years, so did our average debt balance. The graph of our debt balance during the year illustrates this point well, showing that the peaks are getting higher each year and so are the valleys.

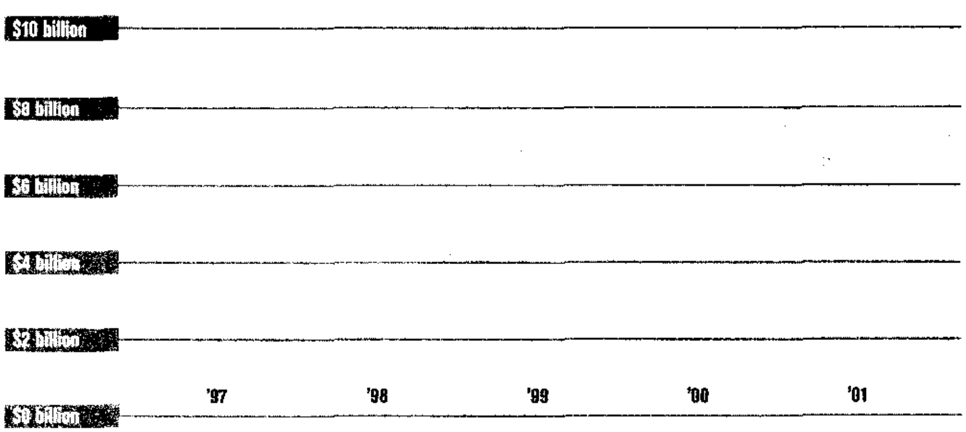
For 2001, our average outstanding debt during the year was far less than the year-end balance, but increased 36%, or $1.7 billion, to $6.4 billion. The interest we paid on our debt totaled $306 million in 2001, compared to $220 million in 2000. Minimizing cash and debt on a daily basis produces good effects because average debt is one driver of annual interest expense, as is evident in a comparison of 1997 with 2001. In 2001, while we continued to minimize cash, our average debt outstanding was $2 billion higher than 1997, a 45% increase. Yet our interest expense was below our 1997 expense, as we took advantage of lower interest rates on our debt.

Debt/Average Debt/Interest Expense

	Year-End Debt *$billions*	Average Debt *$billions*	Interest Expense *$millions*
2001	**11.3**	**6.4**	**306**
2000	9.3	4.7	220
1999	6.9	3.9	158
1998	6.4	3.2	167
1997	5.9	4.4	307

Debt Increase During the Year*

Debt is Increasing at Year-end, and So Is Average Debt During the Year.



** Plotted by accounting period*

Managing Net Interest Expense and Risk

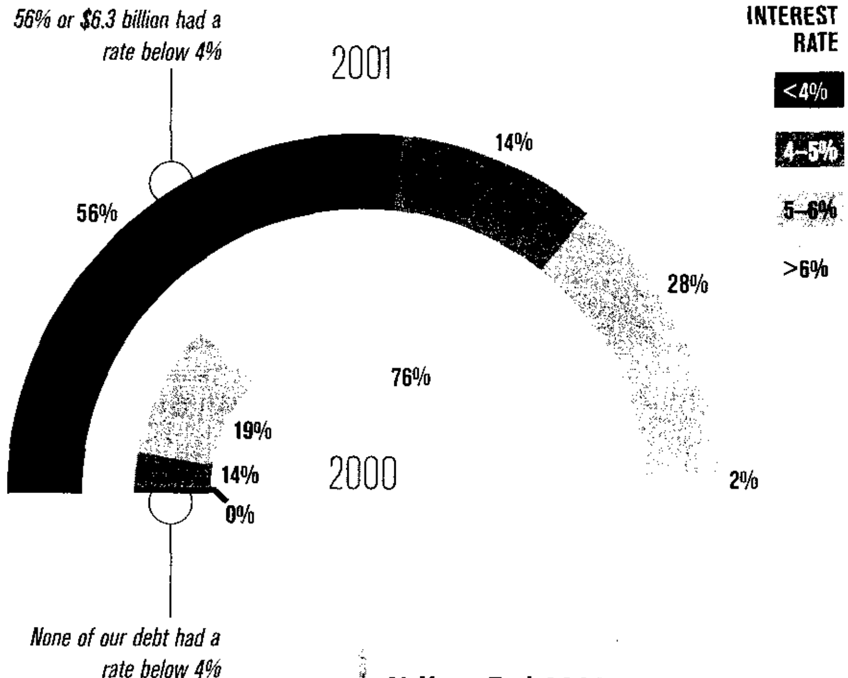
Our interest expense is determined by the interaction of a number of variables including day-to-day cash flows, the behavior of interest rates, and our debt management activities. It was a challenge to manage interest expense during a year of increasing average debt outstanding. We cannot claim any credit for lower interest rates, but we did position our debt portfolio in such a manner that we benefited from declining rates while at the same time taking some steps to stabilize future interest expense volatility.

We prefer to maintain a mix of fixed- and floating-rate debt because we believe that, over the long-term, variable or floating rate debt may provide more cost-effective financing than 100% fixed-rate debt. However, we strive for a favorable balance, and we will borrow fixed-rate debt when market opportunities arise, or when we believe doing so reduces risk. In contrast to the end of the prior fiscal year, where 76% of our debt portfolio had a rate above 6%, we now have only one loan outstanding with a rate above 6%, representing just 2% of our debt portfolio.

At year-end, our long-term debt was $5.75 billion, with a weighted average interest rate of 5.17%, in comparison with $2.55 billion and a weighted average rate of 5.65% at the end of 2000. Our 2001 borrowing transactions with a five-year maturity ranged from a high of 5.42% to a low of 4.44%. The weighted average interest rate on our total debt portfolio at year-end is now 3.86% compared to 6.13% last year. As we enter the new fiscal year, our debt portfolio puts us in a good position to manage interest expense and risk for next year and beyond.

For 2002, we anticipated a financing plan with a $1.6 billion net increase in our debt. However, we made that estimate before the attacks of September 11 and following. Because of present and future uncertainty, we cannot predict the net increase in our debt with any degree of certainty.

At the End of 2001, Only $250 Million or 2% of Our Debt Had a Rate Above 6%.



At Year-End 2000, $7 Billion or 76% of Our Debt Had an Interest Rate Above 6%.

AUDITOR'S report

Board of Governors
United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2001 and 2000, and the related statements of operations, changes in net capital deficiency and cash flows for each of the three years in the period ended September 30, 2001. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards for financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2001, in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have issued our report dated November 9, 2001, on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report when considering the results of our audit.

Ernst + Young LLP

Washington, D.C.
November 9, 2001

statements of OPERATIONS

(dollars in millions)	2001	2000	1999
		Year ended September 30,	
Operating revenue — Note 7	**$65,834**	$64,540	$62,726
Operating expenses:			
Compensation and benefits — Notes 2, 3, 4 and 6	**51,351**	49,532	47,333
Transportation	**5,056**	4,709	4,267
Other	**9,233**	8,751	9,042
Total operating expenses	**65,640**	62,992	60,642
Income from operations	**194**	1,548	2,084
Interest and investment income	**35**	41	29
Interest expense on deferred retirement liabilities — Note 6	**(1,603)**	(1,568)	(1,592)
Interest expense on borrowings	**(306)**	(220)	(158)
Net (Loss) Income	**$(1,680)**	$ (199)	$ 363

See accompanying notes to financial statements.

BALANCE sheets

(dollars in millions)	September 30, 2001	2000
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents–Note 2	**$ 1,005**	$ 683
Receivables:		
Foreign countries	**379**	349
U.S. government	**133**	134
Consignment	**55**	55
Other	**151**	158
	718	696
Less allowances	**110**	107
Total receivables, net	**608**	589
Supplies, advances and prepayments	**320**	383
TOTAL CURRENT ASSETS	**1,933**	1,655
OTHER ASSETS, PRINCIPALLY REVENUE FORGONE APPROPRIATIONS RECEIVABLE–NOTE 7	**372**	375
PROPERTY AND EQUIPMENT, AT COST:		
Buildings	**18,808**	17,685
Equipment	**15,456**	13,973
Land	**2,684**	2,534
Leasehold improvements	**1,163**	1,133
	38,111	35,325
Less allowances for depreciation and amortization	**15,317**	13,644
	22,794	21,681
Construction in progress	**1,969**	2,389
TOTAL PROPERTY AND EQUIPMENT, NET	**24,763**	24,070
DEFERRED RETIREMENT COSTS – Note 6	**32,023**	32,183
TOTAL ASSETS	**$59,091**	$58,283

See accompanying notes to financial statements.

(dollars in millions)	September 30, 2001	2000
LIABILITIES AND NET CAPITAL DEFICIENCY		
CURRENT LIABILITIES:		
Compensation and benefits	**$5,810**	$5,295
Estimated prepaid postage	**1,623**	1,594
Payables and accrued expenses:		
Foreign countries	**499**	439
U.S. government	**151**	150
Other	**956**	1,300
Total payables and accrued expenses	**1,606**	1,889
Prepaid box rentals, permit and metered mail	**1,866**	1,969
Outstanding postal money orders	**988**	716
Current portion of long-term debt	**5,564**	6,814
TOTAL CURRENT LIABILITIES	**17,457**	18,277
LONG-TERM DEBT, LESS CURRENT PORTION – NOTE 5	**5,751**	2,502
OTHER LIABILITIES:		
Amounts payable for deferred retirement benefits – Note 6	**29,932**	30,212
Workers' compensation costs – Notes 2 and 3	**5,167**	5,029
Employees' accumulated leave	**2,124**	2,090
Other	**986**	819
TOTAL OTHER LIABILITIES	**38,209**	38,150
COMMITMENTS and CONTINGENCIES – Notes 8 and 9		
TOTAL LIABILITIES	**61,417**	58,929
NET CAPITAL DEFICIENCY:		
Capital contributions of the U.S. government	**3,034**	3,034
Deficit since reorganization	**(5,360)**	(3,680)
TOTAL NET CAPITAL DEFICIENCY	**(2,326)**	(646)
TOTAL LIABILITIES AND NET CAPITAL DEFICIENCY	**$59,091**	$58,283

See accompanying notes to financial statements.

statements of changes in **NET CAPITAL DEFICIENCY**

Year ended September 30, 2001, 2000, and 1999

(dollars in millions)	Capital Contributions of U.S. Government	Deficit Since Reorganization	Total Net Capital Deficiency
Balance, September 30, 1998	$ 3,034	$ (3,844)	$ (810)
Net Income	-	363	363
Balance, September 30, 1999	3,034	(3,481)	(447)
Net Loss	-	(199)	(199)
Balance, September 30, 2000	3,034	(3,680)	(646)
Net Loss	-	**(1,680)**	**(1,680)**
Balance, September 30, 2001	**$3,034**	**$(5,360)**	**$(2,326)**

See accompanying notes to financial statements.

statements of **CASH FLOWS**

(dollars in millions)	2001	2000	1999
		Year ended September 30,	
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss) income	**$(1,680)**	$ (199)	$ 363
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	**2,223**	2,029	1,795
Loss (gain) on disposals of property and equipment, net	**16**	(5)	(55)
Decrease in other assets, principally revenue forgone appropriations receivable	**3**	1	3
Increase in USPS workers' compensation	**244**	254	19
Decrease in Post Office Department workers' compensation	**(21)**	(17)	(21)
Increase in employees' accumulated leave	**34**	49	82
Increase (decrease) in other liabilities	**167**	(20)	207
Changes in current assets and liabilities:			
(Increase) decrease in receivables, net	**(19)**	(11)	207
Decrease (increase) in supplies, advances and prepayments	**63**	4	(39)
Increase (decrease) in compensation and benefits	**310**	(892)	503
Increase (decrease) in estimated prepaid postage	**29**	(34)	(45)
(Decrease) increase in payables and accrued expenses	**(283)**	225	(371)
(Decrease) increase in prepaid box rentals, permit and metered mail	**(103)**	(80)	94
Increase (decrease) in outstanding postal money orders	**272**	(97)	121
Net cash provided by operating activities	**1,255**	1,207	2,863
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	**(2,961)**	(3,337)	(3,917)
Proceeds from sale of property and equipment	**29**	83	129
Net cash used in investing activities	**(2,932)**	(3,254)	(3,788)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of debt	**5,651**	5,550	4,129
Payments on debt	**(3,652)**	(3,151)	(3,633)
Net cash provided by financing activities	**1,999**	2,399	496
Net increase (decrease) in cash and cash equivalents	**322**	352	(429)
Cash and cash equivalents at beginning of year	**683**	331	760
Cash and cash equivalents at end of year	**$1,005**	$ 683	$ 331

See accompanying notes to financial statements.

NOTES to the FINANCIAL STATEMENTS

In 1971
We Moved
87 Billion
Pieces of Mail.

In 2001
We Moved
207 Billion
Pieces of Mail.

1 Description of Business

Nature of Operations

The United States Postal Service (Postal Service) provides mail service to the public, offering a variety of classes of mail services without discrimination among its many customers. This means that within each class of mail our price does not vary by customer for the levels of service we provide. This fulfills our legal mandate to offer universal services at a fair price. Our primary lines of business are First-Class Mail, Standard Mail and Priority Mail. The principal markets for these services are the communications, distribution and delivery, advertising and retail markets. Our products are distributed through our more than 38,000 post offices and a large network of consignees. As in the past, we continue to conduct our significant operations primarily in the domestic market, with our international operations representing less than 3% of our total revenue.

Our labor force is primarily represented by the American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union and National Rural Letter Carriers Association. Almost 90% of our career employees are covered by collective bargaining agreements. Three of our largest contracts representing 61% of our career employees expired November 20, 2000. Negotiations have begun between management and the unions, and agreements are expected during fiscal year 2002. Additionally, negotiations have begun between management and another major union that represents 29% of our employees. The current contract for this union expires November 20, 2001.

Postal Reorganization

The Postal Service commenced operations on July 1, 1971, in accordance with the provisions of the Postal Reorganization Act (the Act). The equity that the U.S. government held in the former Post Office Department became the initial capital of the Postal Service. The Postal Service valued the assets of the former Post Office Department at original cost less accumulated depreciation. The initial transfer of assets totaled $1.7 billion, and subsequent cash contributions totaled approximately $1.3 billion, resulting in total government contributions of approximately $3 billion. The U.S. government remained responsible for all the liabilities attributable to operations of the former Post Office Department. However, under the Balanced Budget Act of 1997, the remaining liability for certain Post Office Department costs was transferred to the Postal Service. See Note 3 for additional information on costs transferred to the Postal Service under the Act.

Although the Postal Service is excluded from the U.S. government budgetary process, the Postal Service enters into significant transactions with other government agencies, as disclosed throughout these financial statements.

Price Setting Process

Since 1971, the Act has required the Postal Service to establish prices that cover the costs of operating the postal system. The Act established the independent Postal Rate Commission with oversight responsibility for mail prices, subject to approval by the Governors of the Postal Service. The Act provides for the recovery of financial losses through future rate increases.

2 Summary of Significant Accounting Policies

Basis of Accounting and Use of Estimates

We maintain our accounting records and prepare our financial statements on the accrual basis of accounting. This basis conforms to accounting principles generally accepted in the United States. Following these principles, we made estimates and assumptions that affect the amounts we report in the financial statements and notes. Actual results may differ from our estimates.

Cash Equivalents

Cash equivalents are securities that mature within 90 days or less from the date we buy them.

Current Values of Financial Instruments

The current value of our debt is what it would cost us to pay off the debt if we used the current yield on equivalent U.S. Treasury debt.

Supplies, Advances and Prepayments

Supplies, advances and prepayments are primarily composed of our inventories of supplies, motor vehicle parts, repairable parts for mail processing equipment, and advances to employees for annual leave. We value our inventories at the lower of average cost or current market price. Total inventories amounted to $152 million at the end of 2001 and $173 million at the end of 2000.

Property and Equipment

We record property and equipment at what it costs us to acquire the assets, including the interest we pay on the money we borrow to pay for the construction of major capital additions. This interest amounted to $50 million in 2001, $49 million in 2000 and $59 million in 1999.

We depreciate buildings and equipment over their estimated useful lives, which range from 3 to 40 years, using the straight-line method. We amortize leasehold improvements over the period of the lease or the useful life of the improvement, whichever time is shorter.

Impaired Assets

We record losses on long-lived assets when events and circumstances indicate that the assets might be impaired. In accordance with FASB Statement No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed of," we have written down our impaired assets to the lower of cost or fair value. No material impairments were recorded in 2001, 2000 and 1999.

Estimated Prepaid Postage

This is the amount of cash we estimate that we collected by the end of the year for services that we will perform in the following year.

Compensation and Benefits Payable

This is the salaries and benefits we owe to current and retired employees, including the amounts employees have earned but have not yet been paid, current workers' compensation, unemployment costs, health benefits and the current portion of the amounts payable for retirement benefits.

Deferred Retirement Benefits and Costs

This is the present value of our estimated legal obligation to the Civil Service Retirement and Disability Fund for the amount of retirement benefits payable in the future for our current CSRS employees' retirement and our present retirees and their survivors. The present value of our benefits payable for our current CSRS employees increases when management increases basic pay. The present value of our benefits payable also increases when cost of living adjustments (COLAs) are granted to our CSRS retirees or their survivors. We capitalize as deferred retirement costs the amounts due and payable in future years. We expense and pay these costs over periods of 30 years for amounts attributable to current employees and 15 years for amounts attributable to retirees, at 5% interest. We account for our participation in the U.S. government sponsored retirement plans as participation in a multi-employer plan arrangement.

Post-Retirement Health Benefits

Retiree health benefits costs are our obligation to pay a portion of the health insurance premiums of those retirees and their survivors who participate in the Federal Employees Health Benefits Program (FEHBP). We account for our participation in FEHBP as participation in a multi-employer plan arrangement. Therefore, we expense the costs of our retiree health benefits as we incur them.

Workers' Compensation Costs

We are self-insured for workers' compensation costs under a program administered by the Department of Labor (DOL). We record these costs, which include the employees' medical expenses and payment for continuation of wages, as an operating expense. At the end of the year, our liability represents the estimated present value of the total amounts we expect to pay in the future for postal workers injured through the end of fiscal year 2001. We base our estimate of the total costs of a claim upon the severity of the injury, the age of the injured employee, the assumed life expectancy of the employee, the trend of our experience with such an injury, and other factors. In our calculation of present value, we use a net discount rate of 1.4% for medical expenses and 3.0% for compensation claims.

Research and Development Costs

We record research and development costs as expenses when we incur them. These costs were $29 million in 2001, $42 million in 2000 and $67 million in 1999.

We Are the Second Largest Employer In the Country.

Our 776,000 career employees include 270,000 clerks, 240,000 city delivery carriers, 60,000 mail handlers and 60,000 rural delivery carriers.

Advertising

We record advertising costs as expenses when we incur them. These costs were $146 million in 2001, $151 million in 2000 and $241 million in 1999.

Reclassification of Prior Years' Amounts

Certain prior years' amounts have been reclassified to conform to the 2001 presentation.

3 Workers' Compensation

At the end of fiscal year 2001, we estimate our total liability for future workers' compensation costs, excluding Post Office Department (POD) liability, at $5,804 million. At the end of 2000, this liability was $5,560 million. In 2001, we recorded $970 million in workers' compensation expense, compared to the $911 million we recorded in 2000 and the $603 million we recorded in 1999. Our liability for future workers' compensation costs for POD claims was $172 million in 2001 and $193 million in 2000. In 2001, we recorded an expense of $9 million for POD, compared to the $14 million we recorded in 2000 and $11 million in 1999.

In fiscal year 2000, we refined our methodology used to estimate the present value of the total amounts we expect to pay for current Postal Service workers' compensation claims. The major refinement is the use of a life table that reflects long-term experience with a disabled population to estimate mortality rates of our permanently disabled population. Previously, we had used a life table that reflected experience with the general United States population. In management's opinion, the refinements result in a better estimation of our liability for future outlays on behalf of Postal Service workers' compensation claimants. The effect of the refinements was a reduction of $423 million in the fiscal year 2000 compensation and benefits expense.

In fiscal year 1999, we adopted a change in the net discount rate used in determining the present value of estimated future workers' compensation payments for medical claims. The net discount rate for medical claims was changed from 0.1% to 1.4%. The effect of the adoption of this rate has been accounted for as a change in accounting estimate. It resulted in a decrease of $131 million in the fiscal year 1999 compensation and benefits expense. In management's opinion, this net discount rate better reflects the excess of rates of return on government debt instruments of comparable terms relative to expected future medical inflation.

4 Post-Retirement Health Benefit Programs

Employees of the Postal Service who participate in the Federal Employees Health Benefits Program (FEHBP) for at least the five years immediately before their retirement may participate in the FEHBP during their retirement. Under the FEHBP, we pay a portion of the health insurance premiums of participating retirees and their survivors. This program is administered by the Office of Personnel Management.

The Omnibus Budget Reconciliation Act of 1990 requires us to pay the employer's share of health insurance premiums for all employees, and their survivors, who participate in the FEHBP and who retire on or after July 1, 1971. However, we do not include the costs attributable to Federal civilian service before that date. Our FEHBP costs amounted to $858 million in 2001, $744 million in 2000 and $593 million in 1999. We include these costs in our compensation and benefits expense.

5 Debt and Related Interest Costs

Under the Postal Reorganization Act, as amended by Public Law 101-227, we can issue debt obligations. However, we are limited to net annual increases of $2 billion in our debt for capital improvements and to $1 billion for operating expenses. Our total debt cannot exceed $15 billion.

Debt is due as follows (dollars in millions):

Year	Amount
2002	$5,564
2003	1,150
2004	–
2005	–
2006	950
After 2006	3,651

Cash outlays for interest were $339 million in 2001, $263 million in 2000 and $202 million in 1999.

At year-end, the current estimated market value of our debt is $11,650 million in 2001 and $9,316 million in 2000 (Note 2). All notes payable to the Federal Financing Bank (FFB) may be repurchased at current value at any time with five days' notice of intent to do so.

Our Debt Consists of the Following:
(dollars in millions)

Interest Rate %	Terms *	September 30, 2001	2000
NOTES PAYABLE TO THE FEDERAL FINANCING BANK (FFB):			
6.323	Payable December 28, 2000	$ –	$ 800
6.333	Payable March 1, 2001	–	500
6.183	Payable May 31, 2001	–	800
7.800	Payable $15 million each year to May 31, 2001	–	15
6.323	Repurchasable at par November 30, 2000, February 28, 2001 and May 31, 2001	–	1,000
8.760	Payable $36 million each year to May 31, 2001	–	36
2.521**	Overnight revolving credit facility; final maturity date March 13, 2002	363	262
2.489	Payable March 28, 2002	800	–
2.501	Floating rate; payable December 28, 2001, March 28, 2002 and June 28, 2002	1,000	–
5.568	Payable December 31, 2002	200	200
4.543	Payable February 28, 2003	200	–
2.501***	Short-term, floating rate, revolving credit facility; final maturity date March 12, 2003	3,400	3,400
3.858	Payable July 31, 2003	750	–
4.780	Payable November 15, 2005	200	–
5.412	Payable November 15, 2005	500	–
4.437	Payable May 15, 2006	250	–
5.688	Payable August 15, 2007	400	400
5.546	Payable August 15, 2007	150	150
5.426	Payable May 15, 2008	200	200
4.981	Payable May 15, 2008	200	200
4.910	Payable May 15, 2008	200	200
5.355	Payable August 16, 2010	500	–
4.999	Payable February 15, 2011	200	–
4.925	Payable August 15, 2011	200	–
5.959	Payable November 15, 2027	400	400
5.726	Payable November 15, 2027	100	100
5.606	Payable November 15, 2027	300	300
4.836	Payable November 15, 2027	100	100
6.299	Payable May 15, 2030	250	250
5.591	Payable May 15, 2030	250	–
5.417	Payable February 18, 2031	200	–
		11,313	9,313
Mortgage Notes Payable:			
6.00 to 9.25	Maturing from fiscal years 2002 through 2039 secured by land, buildings and equipment with a carrying amount of $15 million.	2	3
		11,315	9,316
	Less current portion of debt	5,564	6,814
		$5,751	$2,502

* *All debt is repurchasable at any time at a price determined by then current FFB rates.*
** *Prior year rate was 6.350%.*
*** *Prior year rate was 6.323%.*

Our Total Retirement Expense of Almost $9 Billion In 2001 Represents 13% of Our Total Expenses.

6 Retirement Programs

With certain exceptions, employees participate in one of the following three retirement programs based upon the starting date of their employment with the Postal Service. Employee and employer contributions are made to the Civil Service Retirement and Disability Fund (CSRDF), the Dual System or the Federal Employees Retirement System, which are administered by the Office of Personnel Management. Employees may also participate in the Thrift Savings Plan, which is a defined contribution retirement savings and investment plan. Postal Service employees are authorized to participate in the Thrift Savings Plan by the Federal Employees Retirement System Act of 1986. The Plan is administered by the Federal Retirement Thrift Investment Board.

Civil Service Retirement System (CSRS)

Under the Postal Reorganization Act, officers and career employees are covered by the Civil Service Retirement System, which provides a basic annuity and Medicare coverage. The CSRS fund covers substantially all employees hired prior to January 1, 1984. We and the employee contribute to Medicare at the rate prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the CSRS.

Dual Civil Service Retirement System (Dual CSRS)/Social Security System

Employees with prior U.S. government service who were hired between January 1, 1984, and January 1, 1987, are covered by the Dual Civil Service Retirement System/Social Security System. We and the employee contribute to Social Security and Medicare at the rates prescribed by law. We do not match contributions to the Thrift Savings Plan for employees who participate in the Dual System.

Federal Employees Retirement System (FERS)

Effective January 1, 1987, officers and career employees hired since December 31, 1983, except for those covered by the Dual System, are covered by the Federal Employees Retirement System Act of 1986. In addition, employees hired before January 1, 1984, could choose during certain periods in 1987, 1988 and 1998 to participate in the FERS. This system consists of Social Security, a basic annuity plan, and a Thrift Savings Plan.

We and the employee contribute to Social Security and Medicare at the rates prescribed by law. In addition, we are required to contribute to the Thrift Savings Plan a minimum of 1% per year of the basic pay of employees covered by this system. We also match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of a contribution between 3 and 5% of basic pay.

Employer and employee contributions are as follows for each of the three plans for 2001, 2000 and 1999:

	2001	2000	1999
CSRS			
Employer	7.00	7.00	7.00
Employee	7.00	7.40	7.25
Dual CSRS			
Employer	7.00	7.00	7.00
Employee	0.80	1.20	1.05
FERS			
Employer	10.70	10.70	10.70
Employee	0.80	1.20	1.05

The number of employees enrolled in each of the retirement plans at the end of 2001, 2000 and 1999 is as follows:

	2001	2000	1999*
CSRS	248,347	263,383	281,062
Dual CSRS	11,440	12,021	12,598
FERS	514,870	510,509	503,233

** From July 1998 to December 1998 workers covered by CSRS were allowed to switch to FERS. During this period only 3,436, or less than 1.2%, of our employees chose to change plans.*

Deferred Retirement Costs

Deferred retirement costs consist of the following (dollars in millions):

	2001	2000
CSRS basic pay increases	$24,843	$25,857
CSRS retirees' and survivors' cost of living adjustments	7,180	6,326
Total	$32,023	$32,183

There are no deferred retirement costs associated with FERS.

Deferred Retirement Liability — Civil Service Retirement System

When we increase CSRS employees' current basic pay, we are liable for the additional deferred retirement liability. The Office of Personnel Management determines the estimated increase in our deferred liability resulting from basic pay increases. We amortize and pay this amount in 30 equal annual installments, which includes interest computed at a rate of 5% per year. We make the first payment at the end of the year in which employees receive their pay increase.

The increase in our deferred liability for retirement benefits under the CSRS as a result of basic pay increases was $319 million in 2001, $1,635 million in 2000 and $930 million in 1999.

Deferred Retirement Liability — Retirees' and Their Survivors' Cost of Living Adjustments (COLAs)

Congress determines the COLAs granted to our retirees. Under the Omnibus Budget Reconciliation Act of 1990, we are liable for our share of the cost of living adjustments granted to those retirees, and their survivors, retiring on or after July 1, 1971. We are not responsible for any costs due to federal civilian service before that date.

Each year the Office of Personnel Management determines the estimated increase in our liability under this law for the current year. We amortize and pay each year's amount in 15 equal annual installments, which include interest computed at a rate of 5% per year.

The increase in our deferred liability for our retirees' COLAs was $1,668 million in 2001, $1,056 million in 2000 and $537 million in 1999.

Future Minimum Payments

We estimate the future minimum payments we have to make in order to fund CSRS benefits and retirees' cost of living adjustments as of September 30, 2001, are as follows (dollars in millions):

Year	Amount
2002	$ 3,681
2003	3,602
2004	3,482
2005	3,391
2006	3,087
After 2006	30,573
	47,816
Less amount representing interest	15,793
Total future minimum payments	32,023
Less: Portion classified as a current liability in compensation and benefits	2,091
Long-term portion of future minimum payments	$29,932

Expense Components

The following table lists the components of our total retirement expenses that are included in our compensation and benefits expense and related interest expense in the Statements of Operations for 2001, 2000 and 1999 (dollars in millions):

	2001	2000	1999
CSRS	$ 769	$ 795	$ 816
FERS	2,046	1,944	1,824
FERS–Thrift Savings Plan	789	750	681
Dual CSRS	33	35	35
Social Security	1,498	1,427	1,337
Amortization of deferred cost:			
CSRS	1,333	1,327	1,214
Annuitant COLAs	814	683	602
Interest expense on deferred liabilities	1,603	1,568	1,592
Total retirement expense	$8,885	$8,529	$8,101

Employer cash contributions to retirement plans were $5,799 million in 2001, $5,516 million in 2000 and $5,164 million in 1999. These amounts do not include Social Security and Medicare contributions and interest expense on deferred retirement liabilities.

7 Revenue Forgone

Our operating revenue includes accruals for revenue forgone. Revenue is forgone when Congress mandates that we provide free mail for certain mailers. Congress appropriates money to reimburse us for only a portion of the revenue forgone that we have incurred in past years. In our operating revenue, we have included as revenue the amounts appropriated by Congress for revenue forgone of $67 million for 2001, $64 million for 2000, and $71 million for 1999. Legislation that was passed during 2001 appropriated the $67 million for 2001 but delayed the payment until fiscal year 2002. Accordingly, we have recorded this as a receivable.

Under the Revenue Forgone Reform Act of 1993, Congress is required to reimburse us $29 million annually through 2035 (42 years). This reimbursement is for two purposes: services we performed in 1991, 1992 and 1993 for which we have not yet been paid; and for shortfalls in the reimbursement for the costs we incurred for processing and delivering certain nonprofit mail from 1994 through 1998.

The Revenue Forgone Reform Act of 1993 authorized a total of $1.218 billion in payments. We calculated the present value of these future reimbursements to be approximately $390 million at 7% interest. We recognized the $390 million as revenue during fiscal years 1991 through 1998. The amounts receivable as of September 30, 2001 and 2000 were $373 million and $375 million, respectively.

8 Commitments

At September 30, 2001, we estimate our financial commitment for approved Postal Service capital projects in progress to be approximately $1,887 million.

Our total rental expense for the years ended September 30 is summarized as follows (dollars in millions):

	2001	2000	1999
Non cancelable real estate leases including related taxes	$ 863	$ 806	$766
Facilities leased from General Services Administration subject to 120-day notice of cancellation	41	39	36
Equipment and other short-term rentals	312	254	431
Total	$1,216	$1,099	$1,233

At September 30, 2001, our future minimum lease payments for all non cancelable leases are as follows (dollars in millions):

Year	Operating	Capital
2002	$ 784	$ 88
2003	758	88
2004	727	88
2005	676	88
2006	620	88
After 2006	5,818	562
	$9,383	$1,002
Less: Interest at 5.5%		257
Total capital lease obligations		745
Less: Short-term portion of capital lease obligations		48
Long-term portion of capital lease obligations		$697

Most of these leases contain renewal options for periods ranging from 3 to 20 years. Certain non cancelable real estate leases give us the option to purchase the facilities at prices specified in the leases.

Capital leases included in buildings were $909 million in 2001 and $787 million in 2000. Total accumulated amortization is $211 million in 2001 and $163 million in 2000. Amortization expense for assets recorded under capital leases is included in depreciation expense.

9 Contingent Liabilities

Each quarter we review litigation pending against us. As a result of this review, we classify and adjust our contingencies for claims that we think it is probable that we will lose and for which we can reasonably estimate the amount of the unfavorable outcome. These claims cover labor, equal employment opportunity, environmental issues, traffic accidents, injuries on postal properties, personal claims and property damages, and suits and claims arising from postal contracts. We also recognize the settlements of claims and lawsuits and revisions of other estimates. Additionally, we evaluate the materiality of cases determined to have a reasonably possible chance of adverse outcome. Such cases are immaterial to our financial statements taken as a whole.

As a part of our continuing evaluation of estimates required in the preparation of our financial statements, we recorded approximately a $35 million increase in liabilities in 2001, $63 million in 2000 and $104 million in 1999, to recognize changes in the estimated cost of litigation and claims asserted in prior years. We recognized settlements of claims and lawsuits and revised other estimates in our changes in contingent liabilities. Management and General Counsel believe that we have made adequate provision for the amounts that may become due under the suits, claims and proceedings we have discussed here.

10 Subsequent Event

Subsequent to the close of the fiscal year, the United States became the target of biological terrorism. These activities affected the Postal Service because the infectious biological agents were sent by mail, causing the death of two employees, the curtailment of mail services in some areas, the decline in mail volume and necessitating the development of and investment in new health and safety measures. The costs of terrorism and health and safety investments and the amount of decreased mail volumes cannot be quantified at this time. The President of the United States has authorized an initial funding of $175 million for fiscal year 2002 to assist in paying for these measures. It is anticipated that additional cash requirements resulting from the impact of terrorism and our related health and safety investments will be funded through a combination of debt, appropriations and rate increases.

OPERATING STATISTICS

	2001	2000	1999	1998	1997
Headquarters Career Employees*					
Headquarters	1,836	2,279	2,372	2,231	1,949
Headquarters-Field Support Units	5,653	5,566	4,357	4,307	4,319
Inspection Service (field)	4,047	4,190	4,334	4,280	4,347
Inspector General	713	664	387	223	101
Total HQ and Related Employees*	**12,249**	**12,699**	**11,450**	**11,041**	**10,716**
Field Career Employees*					
Area Offices	1,377	1,597	1,875	1,703	1,566
Postmasters/Installation Heads	26,113	26,121	26,108	26,156	26,256
Supervisors/Managers	38,754	38,797	38,835	36,508	35,708
Prof. Admin. Tech. Personnel	9,764	9,959	11,097	11,703	11,369
Clerks	269,792	281,956	292,400	293,829	280,818
Nurses	180	191	188	189	193
Mail Handlers	60,102	60,851	62,237	62,247	59,147
City Delivery Carriers	240,295	241,079	242,300	240,813	234,033
Motor Vehicles Operators	9,325	9,347	9,270	9,026	8,625
Rural Delivery Carriers-Full Time	59,790	57,111	54,588	52,241	49,957
Special Delivery Messengers				7	1,331
Bldg. and Equip. Maintenance Personnel	42,604	42,284	41,873	41,054	39,954
Vehicle Maintenance Personnel	5,558	5,546	5,574	5,524	5,501
Total Field Career Employees*	**763,654**	**774,839**	**786,345**	**781,000**	**754,458**
Total Career Employees	**775,903**	**787,538**	**797,795**	**792,041**	**765,174**
Non-Career Employees*					
Casuals	30,317	29,572	25,067	25,711	32,615
Non-Bargaining Temporary	761	712	707	784	774
Rural Subs/RCA/RCR/AUX	58,134	57,532	57,357	56,265	54,834
PM Relief/Leave Replacements	12,313	12,423	2,485	12,613	12,687
Transitional Employees	13,577	13,461	12,355	17,222	26,789
Total Non-Career Employees*	**115,102**	**113,700**	**107,971**	**112,595**	**127,699**
Total Employees	**891,005**	**901,238**	**905,766**	**904,636**	**892,873**
Offices, Stations and Branches					
Post Offices	27,876	27,876	27,893	27,952	28,060
Classified stations and branches	5,835	5,802	5,788	5,661	5,446
Contract stations and branches	2,876	2,833	2,903	2,974	2,907
Community Post Offices	1,536	1,549	1,585	1,572	1,606
Total Offices, Stations and Branches	**38,123**	**38,060**	**38,169**	**38,159**	**38,019**
Residential Delivery Points					
City	76,578,169	76,131,249	75,575,844	75,088,866	74,646,109
Rural	31,004,518	29,915,385	28,753,812	27,683,441	26,707,304
PO Box	15,818,625	15,904,400	16,048,325	16,575,127	16,777,352
Highway Contract	2,004,837	1,938,395	1,857,689	1,784,522	1,703,602
Total Residential	**125,406,149**	**123,889,429**	**122,235,670**	**121,131,956**	**119,834,367**
Business Delivery Points					
City	7,183,431	7,197,776	7,175,729	7,164,995	7,149,055
Rural	1,071,201	1,013,269	956,301	901,124	850,468
PO Box	3,969,279	3,796,343	3,638,737	3,351,603	3,157,513
Highway Contract	52,247	49,234	46,237	43,735	40,049
Total Business	**12,276,158**	**12,056,622**	**11,817,004**	**11,461,457**	**11,197,085**
Total Delivery Points	**137,682,307**	**135,946,051**	**134,052,674**	**132,593,413**	**131,031,452**
Change in Delivery Points	1,736,256	1,893,377	1,459,261	1,561,961	1,724,914

** Complement data from On-Rolls and Paid Employees Statistics database.*

(in millions of units indicated) Class of Mail	2001	2000	1999*	1998	1997
First-Class Mail					
Pieces, number	**103,655.6**	103,525.7	101,936.5	100,434.2	99,659.9
Weight, pounds	**4,362.8**	4,392.0	4,299.9	4,151.3	4,115.1
Revenue	**$35,876.0**	$35,515.9	$34,933.2	$33,861.2	$33,397.6
Priority Mail					
Pieces, number	**1,117.8**	1,222.5	1,189.5	1,174.4	1,068.2
Weight, pounds	**2,149.7**	2,352.3	2,142.6	1,980.0	1,860.6
Revenue	**$4,916.4**	$4,837.1	$4,533.3	$4,187.4	$3,856.9
Express Mail					
Pieces, number	**69.4**	70.9	68.7	66.2	63.6
Weight, pounds	**72.1**	80.0	78.3	77.7	76.3
Revenue	**$995.7**	$996.1	$942.0	$854.5	$824.7
Mailgrams					
Pieces, number	**3.3**	3.7	4.1	4.3	5.3
Revenue	**$1.4**	$1.5	$1.6	$1.7	$2.0
Periodicals					
Pieces, number	**10,077.4**	10,364.8	10,273.8	10,316.8	10,411.4
Weight, pounds	**4,408.3**	4,720.3	4,482.6	4,451.1	4,338.3
Revenue	**$2,205.2**	$2,170.7	$2,115.3	$2,072.3	$2,067.5
Standard Mail					
Pieces, number	**89,938.4**	90,057.1	85,661.7	82,508.1	77,253.6
Weight, pounds	**10,822.2**	11,142.6	10,648.3	10,376.8	9,693.9
Revenue	**$15,704.9**	$15,193.3	$14,435.8	$13,701.7	$12,876.0
Package Services					
Pieces, number	**1,093.0**	1,128.4	1,043.1	1,023.4	988.4
Weight, pounds	**3,801.7**	3,773.8	3,533.2	3,407.3	2,889.9
Revenue	**$1,993.9**	$1,912.3	$1,828.5	$1,754.3	$1,627.6
International Economy Mail					
Pieces, number	**60.4**	78.7	103.2	95.6	97.4
Weight, pounds	**80.3**	89.4	96.1	95.6	102.0
Revenue	**$177.7**	$180.3	$193.9	$183.7	$192.0
International Airmail					
Pieces, number	**1,022.1**	1,020.7	927.5	848.4	909.5
Weight, pounds	**171.6**	169.7	152.2	149.0	157.2
Revenue**	**$1,554.0**	$1,477.2	$1,434.2	$1,416.1	$1,422.8
U.S. Postal Service					
Pieces, number	**380.6**	362.9	382.3	380.1	377.3
Weight, pounds	**82.3**	95.3	102.6	96.2	88.4
Free Mail for the Blind and Handicapped					
Pieces, number	**44.6**	46.6	53.2	53.2	53.3
Weight, pounds	**24.9**	25.1	26.6	27.2	30.6
TOTALS* **					
Pieces, number	**207,462.6**	207,882.2	201,643.5	196,904.7	190,888.1
Weight, pounds	**25,975.9**	26,840.6	25,562.2	24,812.3	23,352.4
Revenue	**$63,425.2**	$62,284.3	$60,417.8	$58,032.9	$56,267.0

** Certain reclassifications have been made to previously reported international amounts.*
*** Includes foreign postal transaction revenue.*
**** Agency and franked mail are included in their classes of mail, when using official mail. Some totals may not add exactly due to rounding.*

(in millions of units indicated) Class of Mail	2001	2000	1999	1998	1997
Registered*					
Number of articles	**11.4**	13.3	13.7	15.3	16.3
Revenue	**$98.4**	$98.4	$95.2	$89.2	$95.2
Certified*					
Number of articles	**269.0**	270.5	268.1	278.3	284.5
Revenue	**$494.8**	$385.4	$377.3	$385.7	$342.8
Insurance*					
Number of articles	**60.0**	58.0	48.6	40.8	33.7
Revenue	**$123.1**	$108.9	$91.5	$72.5	$61.0
Delivery Receipt Services**					
Number of articles	**421.1**	356.9	249.3	237.3	260.5
Revenue	**$370.8**	$316.8	$284.7	$262.1	$289.4
Collect on Delivery					
Number of articles	**2.7**	4.1	4.0	3.8	4.7
Revenue	**$15.3**	$21.5	$19.8	$17.8	$21.8
Special Delivery					
Number of articles	**0.0**	0.0	0.0	0.0	0.1
Revenue	**$0.0**	$0.0	$0.0	$0.0	$1.4
Money Orders					
Number issued	**227.2**	232.8	220.9	208.6	206.1
Revenue	**$225.4**	$234.7	$228.3	$210.1	$212.2
Face value of issues (non-add)***	**$30,770.3**	$29,945.2	$28,491.4	$26,724.6	$26,180.4
Other					
Box rent revenue	**$699.0**	$684.2	$667.2	$617.4	$577.6
Stamped envelope and card revenue	**$27.1**	$15.4	$30.7	$17.4	$17.1
Other revenue, net	**$287.5**	$326.0	$442.0	$299.8	$247.0
TOTALS					
Special Services revenue	**$2,341.4**	$2,191.2	$2,236.7	$1,972.1	$1,865.6
Mail revenue	**$63,425.2**	$62,284.3	$60,417.8	$58,032.9	$56,267.0
Operating revenue before appropriations	**$65,766.6**	$64,475.6	$62,654.5	$60,005.0	$58,132.6

* *Return receipts have been broken out from registered, certified and insurance special service categories.*

** *Delivery Receipt Services contains Return Receipts, Return Receipts for Merchandise and Delivery Confirmation. Delivery Confirmation Service began during 1999.*

*** *Certain reclassifications have been made to previously reported amounts.*

FINANCIAL HISTORY summary

	2001	2000*	1999*
STATEMENTS OF OPERATIONS			
(dollars in billions)			
Total revenue	**$ 65.9**	$ 64.6	$ 62.7
Total expense	**67.6**	64.8	62.4
Net (loss) income	**$ (1.7)**	$ (0.2)	$ 0.4
(dollars in millions)			
Operating revenue	**$65,767**	$64,476	$62,655
Revenue forgone appropriation	**67**	64	71
Total operating revenue	**65,834**	64,540	62,726
Compensation and benefits	**51,351**	49,532	47,333
Restructuring costs	**–**	–	–
Other expenses	**14,289**	13,460	13,309
Total operating expenses	**65,640**	62,992	60,64
Income from operations	**194**	1,548	2,084
Interest and investment income	**35**	41	29
Interest expense on deferred retirement liabilities	**(1,603)**	(1,568)	(1,592)
Interest expense on borrowings	**(306)**	(220)	(158)
Income (loss) before retroactive assessments and extraordinary items	**(1,680)**	(199)	363
Retroactive assessments for employee benefits**	**–**	–	–
Income (loss) before extraordinary item	**(1,680)**	(199)	363
Extraordinary item–debt refinancing premium	**–**	–	–
Net (loss) income	**$(1,680)**	$(199)	$363
BALANCE SHEETS			
Assets			
Current assets	**$ 1,933**	1,655	$ 1,296
Property and equipment, deferred retirement costs and other assets	**57,158**	56,628	54,713
Total assets	**$59,091**	$58,283	$56,009
Liabilities			
Current liabilities	**$17,457**	$18,277	$15,436
Other liabilities	**38,209**	38,150	37,466
Long-term debt	**5,751**	2,502	3,554
(Net capital deficiency)/equity	**(2,326)**	(646)	(447)
Total liabilities and (net capital deficiency)/equity	**$59,091**	$58,283	$56,009
CHANGES IN (NET CAPITAL DEFICIENCY)/EQUITY			
Beginning balances			
Capital contributions of the U.S. government	**$3,034**	$ 3,034	$ 3,034
Deficit since reorganization	**(3,680)**	(3,481)	(3,844)
Total beginning balance (net capital deficiency)/equity	**(646)**	(447)	(810)
Net (loss) income	**(1,680)**	(199)	363
Ending balance* **	**$(2,326)**	$(646)	$(447)

* *Certain reclassifications have been made to previously reported amounts.*

** *Relates to OBRA 1990 and 1993.*

*** *Some totals may not add exactly due to rounding.*

1998*	1997*	1996*	1995*	1994*	1993*	1992*	1991*
$ 60.1	$ 58.3	$ 56.6	$ 54.5	$ 49.6	$ 48.0	$ 47.1	$ 44.2
59.5	57.0	55.0	52.7	50.5	49.8	47.6	45.7
$ 0.6	$ 1.3	$ 1.6	$ 1.8	$ (0.9)	$ (1.8)	$ (0.5)	$ (1.5)
$60,005	$58,133	$56,309	$54,176	$49,252	$47,418	$46,151	$43,323
67	83	93	117	131	164	545	562
60,072	58,216	56,402	54,293	49,383	47,582	46,696	43,885
45,596	44,093	42,676	41,931	39,609	38,448	37,122	34,904
–	–	–	–	–	129	1,010	–
12,190	11,038	10,437	8,799	8,846	7,745	7,521	7,215
57,786	55,131	53,113	50,730	48,455	46,322	45,653	42,119
2,286	3,343	3,289	3,563	928	1,260	1,043	1,766
44	115	142	216	193	404	409	318
(1,613)	(1,629)	(1,496)	(1,443)	(1,433)	(1,416)	(1,350)	(1,263)
(167)	(307)	(368)	(566)	(601)	(620)	(638)	(480)
550	1,264	1,567	1,770	(913)	(372)	(536)	341
–	–	–	–	–	(857)	–	(1,810)
550	1,264	1,567	1,770	(913)	(1,229)	(536)	(1,469)
–	–	–	–	–	(536)	–	–
$550	$1,264	$1,567	$1,770	$(913)	$(1,765)	$(536)	$(1,469)
$ 1,893	$ 1,736	$ 1,670	$ 2,975	$ 2,683	$ 4,478	$ 6,027	$ 4,863
53,015	51,675	50,157	46,146	43,733	42,803	41,638	38,403
$54,908	$53,411	$51,827	$49,121	$46,416	$47,281	$47,665	$43,266
$15,278	$14,107	$12,796	$11,499	$11,665	$ 10,140	$ 9,484	$ 7,400
37,652	37,439	37,746	34,794	32,985	33,503	32,291	30,474
2,788	3,225	3,909	7,019	7,727	8,686	9,173	8,139
(810)	(1,360)	(2,624)	(4,191)	(5,961)	(5,048)	(3,283)	(2,747)
$54,908	$53,411	$51,827	$49,121	$46,416	$47,281	$47,665	$43,266
$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,034	$ 3,035	$ 3,034
(4,394)	(5,658)	(7,225)	(8,995)	(8,082)	(6,318)	(5,781)	(3,438)
(1,360)	(2,624)	(4,191)	(5,961)	(5,048)	(3,283)	(2,747)	(402)
550	1,264	1,567	1,770	(913)	(1,765)	(536)	(874)
$(810)	$(1,360)	$(2,624)	$(4,191)	$(5,961)	$(5,048)	$(3,283)	$(1,278)

* *Certain reclassifications have been made to previously reported amounts.*

** *Relates to OBRA 1990 and 1993.*

*** *Some totals may not add exactly due to rounding.*

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Vice President and General Counsel

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Deputy Postmaster General

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Vice President, International Business

JOHN R. WARGO
Vice President, Service & Market Development

KENNETH C. WEAVER
Chief Postal Inspector

KARLA W. CORCORAN
Inspector General

GLOSSARY

Accruals: Revenue and expenses that are recorded as they occur, even though they may not have actually been paid.

Anthrax: An infectious disease caused by *Bacillus anthracis*. Human anthrax has three major clinical forms: cutaneous, inhalation and gastrointestinal.

Amortize: To reduce the value of an asset through regular charges to income over time; or to write off expenses by prorating them over a period of time.

Appropriation: Public funds set aside by Congress for a specific purpose.

Bar code: A series of vertical full bars and half bars representing the ZIP Code information printed on a mailpiece to facilitate automated processing by bar code reader equipment.

Biohazard: A biological material especially if infective, that poses a threat to humans or their environment.

Capitalize: To treat an expenditure as an asset; or to compute the present value of a future payment that will be paid over a period of time.

Confirm: A service that allows mailers to identify and track their mailpieces by placing a bar code or PLANET (Postal Alpha Numeric Encoding Technique) Code on the front of their letter or flat.

Contribution: The difference between the revenue from a class of mail and that class's volume-variable costs. For example, if a class of mail has revenue of $1.5 billion and volume-variable costs of $1 billion, its contribution is $500 million, which means that this class of mail covers its costs and contributes $500 million to the common costs of all mail services.

Delivery Confirmation: Delivery Confirmation is a special service designed to provide the date of delivery or attempted delivery for Priority Mail and Standard Mail parcels, bound printed matter and library mail.

Depreciate: To periodically reduce the estimated value of an asset over the course of its useful life.

Deputy Postmaster General (DPMG): A member of the Board of Governors, jointly appointed by the Postmaster General and Governors.

Direct Mail: A form of advertising often employed by businesses to reach targeted groups of potential customers by mail.

Employment Cost Index (ECI): A national indicator of overall employee labor cost and one of the principal economic indicators used by the Federal Reserve Bank.

Equity: The difference between the value of all assets less all liabilities.

Express Mail: The Postal Service's premium delivery service, providing guaranteed overnight delivery for documents and packages weighing up to 70 pounds. Both domestic and international services are offered.

First-Class Mail: A class of mail including letters, postcards, and postal cards, all matter wholly or partially in writing or typewriting, and all matter sealed or otherwise closed against inspection.

Fixed Asset: Any tangible property such as buildings, machinery and equipment, furniture, and leasehold improvements.

Generally Accepted Accounting Principles (GAAP): The rules and procedures of accepted accounting practice as defined by the Financial Accounting Standards Board.

Gross Domestic Product (GDP): The total market value of all the goods and services produced in one year in the United States.

Inspector General: The Inspector General is appointed by and reports directly to the Governors of the Postal Service and is independent of postal management. The Office of Inspector General (OIG) primarily investigates and evaluates programs and operations of the Postal Service to ensure the efficiency and integrity of the postal system.

Irradiation: Treatment or therapy by exposure to radiation.

Leasehold: An asset that gives the Postal Service the right to use property under a lease.

Lettershop: A company that personalizes, labels, sorts and stuffs envelopes in preparation for Standard Mail.

Liability: Any debt or obligation the Postal Service is bound to pay.

Nitrile Gloves: Industrial strength protective hand coverings that are highly resistant to a wide range of chemicals, abrasions and punctures.

Periodicals: A class of mail, formerly called second-class mail, that consists of magazines, newspapers, and other publications.

Point-of-Service ONE (POS ONE): An electronic retail sales device that assists employees with retail transactions and provides product inventory and sales information.

Postal Inspection Service: The investigative arm of the Postal Service responsible for investigating criminal acts involving the mails and misuse of the postal system.

Postal Rate Commission (PRC): An independent federal agency that makes recommendations concerning Postal Service requests for changes in postal rates and mail classifications.

Postmaster General (PMG): The chief executive officer of the Postal Service, appointed by and serving at the pleasure of the Governors.

Present Value: The value today of a future payment that is discounted at a stated rate of compound interest. For example, the present value of $100 that will be paid to the Postal Service 10 years from now is about $38.55, if we discount that $100 at a rate equal to 10 percent interest compounded annually.

Priority Mail: Priority Mail provides two- to three-day delivery service.

Priority Mail Global Guaranteed®: An alliance with DHL Worldwide Express, Inc. providing day-certain delivery guaranteed service to 65 countries around the world.

Processing and Distribution Center (P&DC): A large mail-sorting and dispatching plant that serves as a hub for mail originating from post offices, collection boxes and customer mailboxes, and large-volume mailers in a designated service area.

Receivable: Money that is owed to the Postal Service.

Recognize: To record in Postal Service accounts as income or expense.

Standard Mail: New name for the bulk advertising mail formerly known as Third-Class Mail.

Tracking: Maintenance of records concerning various aspects of mailings such as response rates, mail dates and location of respondents.

U.S. Mail: Any mailable matter that is accepted for mail processing and delivery by the Postal Service.

United States Postal Service (USPS): The successor to the Post Office Department, the USPS was established by the Postal Reorganization Act of July 1, 1971, as an independent, self-supporting federal agency within the executive branch.

Universal Service: The Postal Service's mandate and commitment to the nation to provide mail delivery service at uniform and reasonable rates to everyone, everywhere.

Year: As used in the financial section of this report, it means the Postal Service fiscal year, which is the 12-month period during which the Postal Service keeps accounts, beginning October 1 and closing September 30.

The 800,000 men and women of
the Postal Service perform heroic acts every day.
They live their lives with duty, honor and pride.

Some go beyond even that, performing
acts of special courage or heroism,
suffering injury or making the ultimate
sacrifice in service to others. They are awarded
the Postmaster General's Medal of Freedom.

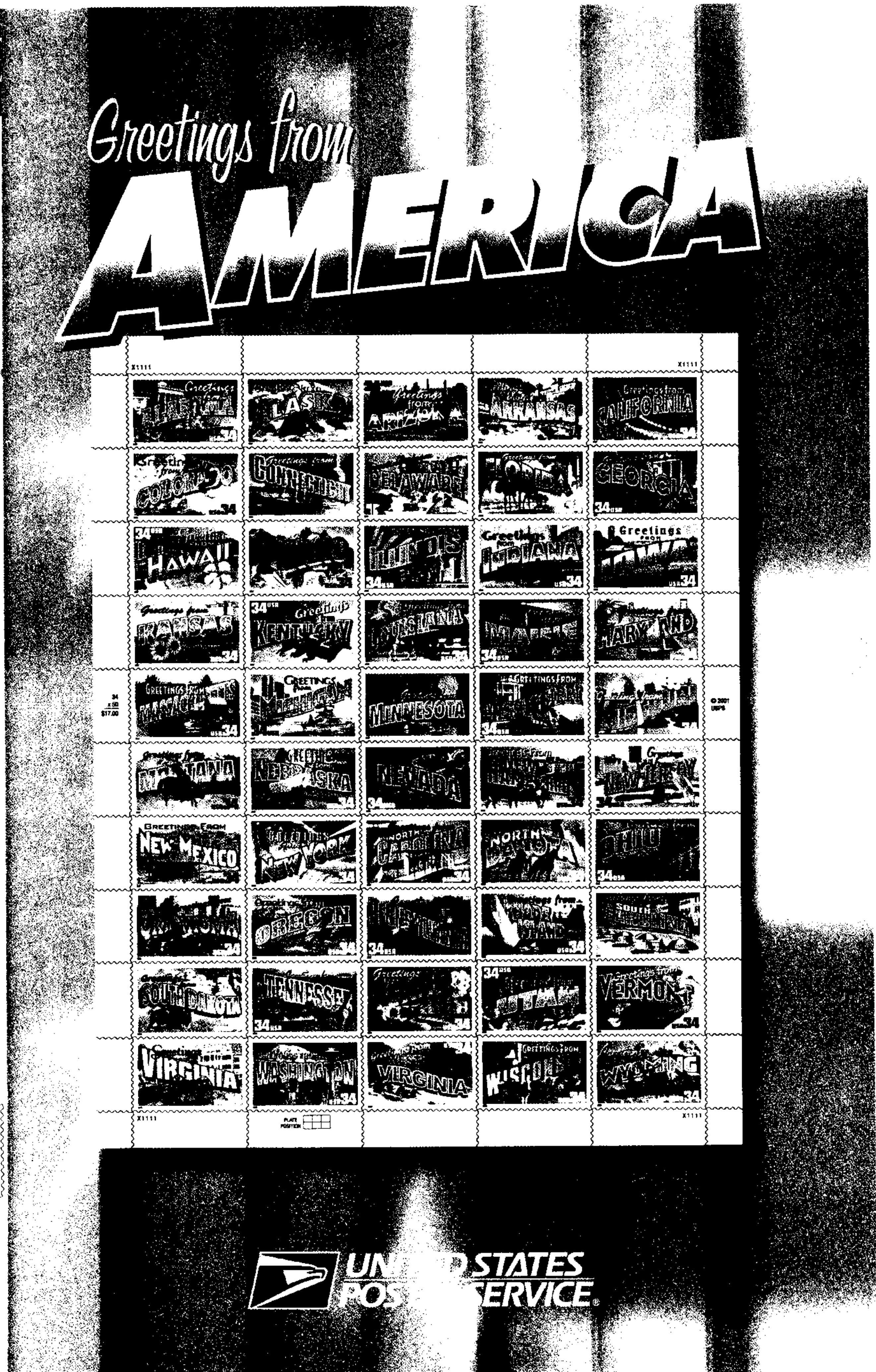
Joseph P. Curseen, Jr.

Thomas L. Morris, Jr.

Neither snow, nor rain, nor gloom of night,
nor winds of change, nor a nation challenged
will stay them from the swift completion of their appointed rounds.

Ever.

UNITED STATES POSTAL SERVICE.
Founded September 26, 1789



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United States Military Academy
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Lunar New Year: Horse
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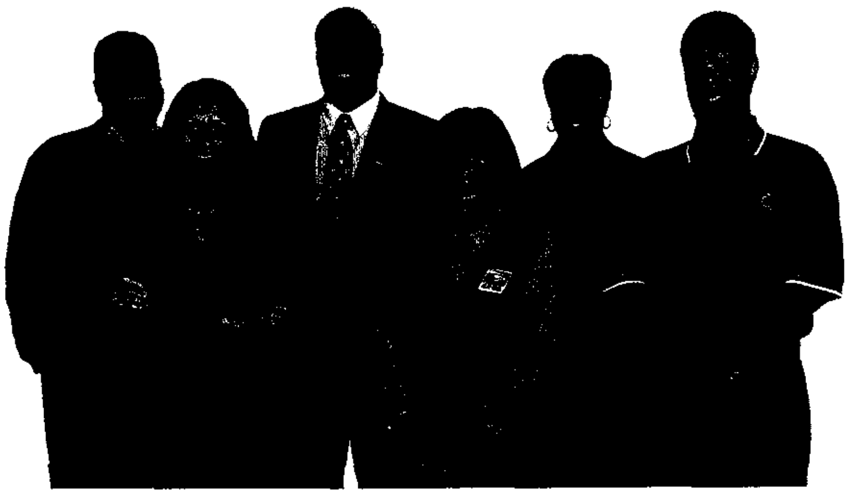

Since September 11th the Postal Service has delivered more than a half billion pieces of mail each day to homes and businesses all across America.

SAFELY.

In times like these, sometimes the most important thing you can do is your job.

Want to meet an everyday hero?

Shake hands with a postal worker.

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